No. 15096

United States Court of Appeals

for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

THE STONECREST CORPORATION and THE BROOKFIELD CORPORATION,
Respondents.

Transcript of Record

Petitions to Review Decisions of The Tax Court of the United States

FILED
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PAUL P. O'BRIEN, CLERK

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.—9-6-57

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

Transcript of Proceedings and Testimony—
(Continued):

Witnesses—(Continued):

APPEARANCES

For Petitioner:

BERT F. RABINOWITZ,
SCOTT H. DUNHAM.

For Respondent:

T. M. MATHER.

Tax Court of the United States

Docket No. 42445

THE STONECREST CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1952

Jul. 3—Petition received and filed. Taxpayer notified. Fee paid.

Jul. 9—Copy of petition served on General Counsel.

Jul. 3—Request for Circuit hearing in San Francisco filed by taxpayer. 7/22/52, granted.

Aug. 19—Answer filed by General Counsel.

Aug. 26—Copy of answer served on taxpayer, San Francisco.

1953

Jul. 31—Hearing set Nov. 2, 1953, San Francisco.

Sep. 21—Motion to consolidate docket numbers 42445 and 42446 and continue to next calendar filed by taxpayer. 9/21/53, granted.

Dec. 22—Hearing set March 15, 1954, San Francisco.

1954

Feb. 2—Motion to amend answer, amendment to answer lodged, filed by General Counsel. 2/3/54, granted, 2/3/54, served.

Feb. 12—Motion to continue to the next calendar in San Francisco filed by petitioner. Granted.

Jul. 13—Hearing set Nov. 1, 1954, San Francisco.

Nov. 4—Hearing had before Judge Tietjens on the merits. Stipulation of facts with exhibits 1-A thru 9-D, attached, filed at hearing. (See Transcript) Briefs due 60 days; replies due 30 days.

Nov. 23—Transcript of Hearing 11/4/54 filed.

Dec. 14—Motion for extension of 60 days from Jan. 3, 1955 to file brief filed by taxpayer. 12/15/54, granted.

1955

Feb. 28—Brief filed by taxpayer. 3/7/55, copy served.

Mar. 4—Brief filed by General Counsel.

Mar. 15—Motion for extension of 30 days from Apr. 3, 1955 to file reply brief filed by taxpayer. Granted 3/16/55.

1955

Apr. 28—Petitioner's reply brief filed. 4/29/55, copy served.

May 3—Reply brief filed by General Counsel. Copy served.

Jul. 14—Findings of fact and opinion filed. J. Tietjens, Decision will be entered under Rule 50. Copy served.

Oct. 11—Agreed computation filed.

Oct. 13—Decision entered, Judge Tietjens, Div. 1.

1956

Jan. 12—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by respondent.

Jan. 20—Proof of service filed. (Counsel)

Jan. 20—Proof of service of petition for review filed. (Petitioner)

Feb. 8—Motion for extension of time to April 11, 1956 for filing the record and docketing the appeal filed by respondent.

Feb. 10—Order extending time to April 11, 1956 for filing the record and docketing the appeal, entered.

Mar. 15—Statement re diminution of record with statement of service by mail thereon filed.

Mar. 15—Statement of Points with statement of service by mail thereon filed.

Tax Court of the United States

Docket No. 42446

THE BROOKFIELD CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1952

Jul. 3—Petition received and filed. Taxpayer notified. Fee paid.

Jul. 9—Copy of petition served on General Counsel.

Jul. 3—Request for Circuit hearing in San Francisco filed by taxpayer. 7/22/52, granted.

Aug. 19—Answer filed by General Counsel.

Aug. 26—Copy of answer served on taxpayer, San Francisco.

1953

Jul. 31—Hearing set Nov. 2, 1953, San Francisco.

Sep. 21—Motion to consolidate dockets 42445 and 42446 and continue to next calendar filed by taxpayer. 9/21/53, granted.

Dec. 22—Hearing set March 15, 1954, San Francisco.

1954

Feb. 2—Motion for leave to amend answer, amendment to answer lodged, filed by General Counsel. 2/3/54, granted. 2/3/54, copy served.

1954

Feb. 12—Motion to continue to the next calendar in San Francisco filed by petitioner. Granted.

Jul. 13—Hearing set Nov. 1, 1954, San Francisco.

Nov. 4—Hearing had before Judge Tietjens on the merits. Stipulation of facts with exhibits 1-A thru 9-D, attached, filed. (See Transcript) Briefs due 60 days; replies due 30 days. [Motion for leave to file amendment to petition granted. Motion and amendment to petition filed.]

Nov. 15—Answer to amendment to petition filed by General Counsel.

Nov. 23—Transcript of hearing 11/4/54 filed.

Dec. 14—Motion for extension of 60 days from Jan. 3, 1955 to file brief filed by taxpayer. 12/15/54, granted.

1955

Feb. 28—Brief filed by taxpayer. Copy served. 3/7/55.

Mar. 4—Brief filed by General Counsel.

Mar. 15—Motion for extension of 30 days from Apr. 3, 1955 to file reply brief filed by taxpayer. 3/16/55, granted.

Apr. 11—Supplemental Stipulation of Facts filed.

Apr. 28—Petitioner's reply brief filed. 4/29/55, copy served.

May 3—Respondent's reply brief filed. Copy served.

1955

Jul. 14—Findings of fact and opinion filed. Tietjens J. Decision will be entered under Rule 50. Copy served.

Oct. 11—Agreed computation filed.

Oct. 13—Decision entered, Judge Tietjens. Div. 1.

1956

Jan. 12—Petition for review by U. S. Court of Appeals, Ninth Circuit, filed by respondent.

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Mar. 15—Statement of points with statement of service by mail thereon filed by respondent.

Mar. 15—Statement re diminution of record with statement of service by mail thereon filed by respondent.

[Title of Tax Court and Cause No. 42445.]

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency issued by the Office of the Internal

Revenue Agent in Charge, San Francisco Division (Symbols: IRA:90-D:CRA (C:AS:PD:SF:HGP)), dated April 9, 1952, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with its principal office at 3455 Nineteenth Avenue, San Francisco, California. The returns for the periods here involved were filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on April 9, 1952.

3. The deficiencies (overassessments) as determined by the Commissioner are deficiencies and overassessments in income tax, declared value excess profits tax and excess profits tax for the taxable years ended December 31, 1942, December 31, 1943, December 31, 1944, and December 31, 1945, as follows:

Taxable Year Ended December 31	Total	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1942,	$191,803.90	$ 3,766,08	$29,678.26	$158,359.56
1943,	41,792.35	(4,422.44)	3,883.19	42,331.60
1944,	(958.02)	(958.02)		
1945,	20,707.04	12,176.55	414.62	8,115.87
Total,	$253,345.27	$10,562.17	$33,976.07	$208,807.03

The amounts of such taxes in controversy are deficiencies (overassessments) in income taxes, de-

clared value excess profits taxes and excess profits taxes for such years as follows:

Taxable Year Ended December 31	Total	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1942,	$191,803.90	$ 3,766.08	$29,678.26	$158,359.56
1943,	41,792.35	(4,422.44)	3,883.19	42,331.60
1944,	(958.02)	(958.02)		
1945,	20,579.83	12,049.34	414.62	8,115.87
Total,	$253,218.06	$10,434.96	$33,976.07	$208,807.03

In addition, this petitioner claims an overassessment of excess profits tax for the year 1943 in the amount of $862.38, which after being offset by a deficiency in income tax for such year in the amount of $193.24, should be refunded to this taxpayer, together with interest thereon.

4. The determination of the taxes set forth in said notice of deficiency is based upon the following errors:

a. The Commissioner erred in determining that for the purpose of the contract price under Section 44 of the Internal Revenue Code, the sales prices of single family residences sold by this petitioner during the years 1942, 1943, 1944 and 1945 should be reduced by the outstanding mortgages thereon to the extent such mortgages did not exceed the basis of such residences to this petitioner.

b. The Commissioner erred in determining that a portion only instead of all of the installment payments actually received by this petitioner during

the years 1942, 1943, 1944 and 1945 should be considered in determining the profits which this petitioner realized during such years from the installment sales of single family residences during the years 1942, 1943, 1944 and 1945.

c. The Commissioner erred in determining that 100% of that portion of the installment payments actually received by this petitioner during the years 1942, 1943, 1944 and 1945 from its sales during 1942, 1943 and 1944, and that 83.5455% of that portion of installment payments actually received by this petitioner during 1945 from its sales during such year (which portions he considered as collections instead of the total installment payments actually received) on such sales constituted profit to it.

d. The Commissioner erred in determining that the gross profit to be realized when payments are completed should be returned as income over a period of less than three years rather than over the entire period in which installment payments are actually received by this petitioner from the purchasers of the residences.

e. The Commissioner erred in determining that the excess of the mortgages outstanding against the homes sold over the basis of the homes to the petitioner constituted a part of the initial payments received by this petitioner.

f. The Commissioner erred in determining that this petitioner realized profit in the year 1942 on such installment sales in the amount of $264,546.49.

g. The Commissioner erred in not allowing this petitioner the net operating loss carry-over from the year 1942 in the amount of $3,898.95.

h. The Commissioner erred in determining that this petitioner realized profit in the year 1943 on such installment sales in the amount of $114,426.17.

i. The Commissioner erred in determining that salaries paid to officers of this petitioner during the year 1944 in the amount of $15,600.00, were not deductible in determining its net income for such year.

j. The Commissioner erred in determining that the petitioner realized profit in the year 1944 on such installment sales in the amount of $53,210.20.

k. The Commissioner erred in determining that salaries paid to the officers of this petitioner during the year 1945 in the amount of $15,600.00, were not deductible in determining its net income for such year.

l. The Commissioner erred in determining that this petitioner realized profits in the year 1945 on such installment sales in the amount of $85,902.04.

m. The Commissioner erred in not allowing additional deductions for California bank and franchise taxes during the years 1942, 1943, 1944 and 1945, which additional taxes would necessarily arise if the determinations of the Commissioner relating to adjustments to this petitioner's income for such period were correct.

5. The facts upon which this petitioner relies as a basis for this proceeding are as follows:

a. This petitioner was incorporated under the

laws of the State of California on December 26, 1941.

b. This petitioner constructed and sold over 400 single family residences during the years 1942, 1943, 1944 and 1945.

c. Sales of such residences during the years 1942, 1943, 1944 and 1945 amounted to $1,593,426.25, $452,450.00, $47,250.00 and $591,500.00, respectively. The costs of such residences to this petitioner were in the respective amounts of $1,250,977.16, $347,-663.12, $35,629.11 and $507,871.00, and the gross profits to be realized from such sales when payments therefor were completed were in the respective amounts of $342,449.09, $104,786.88, $11,620.89 and $83,629.00.

d. Initial payments received in connection with such sales were less than 30% of the sales price thereof.

e. This petitioner was entitled to elect to report the profits from such sales on installment payments under Section 44 of the Internal Revenue Code, and this petitioner did so elect.

f. The sales contract in the case of each sale set forth the full sales price of the residence. The difference between the sales price and the cash down payment constituted the amount of the unpaid balance to the petitioner from the buyer. Such balance was to be paid to the petitioner in monthly installments over a period of twenty-five years, together with interest thereon, and payments to meet taxes and insurance on the property.

g. Each contract recited that a loan was outstanding against the residence at the time of sale, which loan the petitioner as seller agreed to pay.

h. Such loans had been previously made by the San Francisco Bank, San Francisco, California, to the petitioner and were Federal Housing Administration construction loans.

i. The petitioner was directly and primarily liable for the payment of such loans and has remained directly and primarily liable thereon for the unpaid balance thereof up to and including the present time.

j. The petitioner alone was required to make all payments to the bank on such loans and, in fact, it alone has made all such payments directly to the bank with its own funds whether or not it received payments from its purchasers on their obligations to it.

k. None of the purchasers of the residences has, in fact, ever assumed or paid any of such outstanding loans.

l. All payments by the purchasers are required by the agreement of sale to be made and have been made directly to and actually received by this petitioner.

m. Under the contract under which each residence was sold, the purchaser was entitled to a deed free and clear of the bank loan when he had paid the full sales price set forth in the contract.

n. The purchaser did not take the residence subject to the outstanding loan thereon.

o. Under section 44 of the Internal Revenue Code, the formula for determining the percentage of profit realized by a seller on each installment payment received is as follows:

$$\frac{\text{Profit to be realized}}{\text{Contract price}} = \begin{array}{l}\text{Percent of each installment}\\ \text{payment actually received}\\ \text{which constitutes profit.}\end{array}$$

p. Since each residence was neither sold subject to the outstanding loan nor was such loan assumed by the purchaser, Regulations 111, Section 29.44-2 (and the identical provisions of the preceding Regulation) is not applicable in determining the profit realized by this petitioner upon such sales insofar as it provides that the amount of the mortgage to the extent it does not exceed the basis of the property to the seller is not a part of the "contract price", and to the extent that it implies that the amount of the loan in excess of the basis to the seller is a part of the "initial payment" received by the seller.

q. In the case at issue, even if the purchaser took the property subject to the loan, such provisions of Regulations 111, Section 29.44-2, are not applicable to the particular facts here involved since their application would operate to create a rule out of harmony with and in contravention of the provisions of Section 44 of the Internal Revenue Code and of the court decisions interpreting such provisions.

r. If the Commissioner is correct in determining

that the above provisions of Regulations 111, Section 29.44-2, apply to the facts of the instant case, then to that extent such Regulation is a nullity since it operates to create a rule out of harmony with the Internal Revenue Code, neither reasonable nor consistent therewith.

s. As applied to the principal case, the "contract price" for the purpose of determining the amount of profit realized by the petitioner from each installment payment received by a purchaser of a residence is the selling price thereof set forth in the agreement of sale.

t. The total amount of each payment received by the petitioner from each purchaser which is applicable to the principal amount of the unpaid balance of the selling price constitutes the installment payment actually received for the purpose of determining the amount of the profit realized by the petitioner.

u. Under Section 44 of the Internal Revenue Code, this petitioner is entitled and required to return the gross profit to be realized as income over the entire period in which installment payments are actually received by this petitioner from the purchasers of the residences.

v. During the years 1942, 1943, 1944 and 1945, the petitioner properly reported its profits from the sales of the residences made during the years 1942, 1943, 1944 and 1945.

w. The profit realized by the petitioner during the calendar year 1942 from such sales was in the

amount of $28,312.43; such profit for the calendar year 1943 was in the amount of $75,050.55; such profit for the calendar year 1944 was in the amount of $70,692.78; and such profit for the calendar year 1945 was in the amount of $67,921.97.

x. This petitioner was entitled to a net operating loss carry-over from the year 1942 in the amount of $3,898.95.

y. During each of the years 1944 and 1945, this petitioner properly paid salaries to its officers in the amount of $24,000.00, or $12,000.00 each to Ellis L. Stoneson and Henry Stoneson.

z. In view of the fact that such officers were entirely responsible for the operations and success of this petitioner, such salaries were reasonable in all respects and are deductible in computing the net income of this taxpayer in both the calendar year 1944 and the calendar year 1945.

aa. In the event any adjustments to this petitioner's income for 1942, 1943, 1944 and 1945, determined by the Commissioner are sustained, such adjustments would result in additional California bank and franchise taxes.

bb. Such additional California bank and franchise taxes accrue as of the first day of the taxable year for which they are imposed.

cc. This petitioner being on the accrual method of reporting income and expenses, except as to the installment sales of residences, is entitled to deduct

any additional California bank and franchise taxes in the year in which such taxes accrue.

Wherefore, the petitioner prays that this court may hear the proceeding and

(1) Determine that there are no deficiencies in income tax, declared value excess profits tax or excess profits tax for the calendar year 1942; that there is a deficiency in income tax for the calendar year 1943 in the amount of $193.22; that there are no deficiencies in declared value excess profits tax or excess profits tax for such year; that there is a deficiency in income tax for the calendar year 1944 in the amount of $39.65; that there are no deficiencies in declared value excess profits tax or excess profits tax for such year; and that there is a deficiency in income tax for the year 1945 in the amount of $127.21; and that there is no deficiency in declared value excess profits tax and excess profits tax.

(2) Determine that there is an overassessment of excess profits tax for the calendar year 1943 in the amount of $862.38 which should be refunded to this taxpayer, together with interest thereon.

(3) Determine that this petitioner is entitled to deduct in the years in which such taxes accrue any additional California bank and franchise taxes arising from adjustments in this taxpayer's income determined by the Commissioner and sustained by this Court.

(4) Grant such other and further relief as, in

the opinion of the Court, the facts of the case may warrant.

Respectfully submitted,

/s/ BERT F. RABINOWITZ,
Counsel for Petitioner.

/s/ SCOTT H. DUNHAM,
Certified Public Accountant,
Of Counsel.

Duly Verified.

[Endorsed]: T.C.U.S. Filed July 3, 1952.

[Title of Tax Court and Cause No. 42,445.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles W. Davis, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner admits, denies and alleges as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits the deficiencies as determined by the Commissioner are as set forth in paragraph 3 of the petition, but denies the remaining allegations and alleges that the Tax Court has no jurisdiction over overassessments.

4 and 4-a to m, inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph 4 of the petition and subparagraphs a to m, inclusive, thereunder.

5-a to c, inclusive. Admits the allegations contained in subparagraphs a to c, inclusive, of paragraph 5 of the petition.

5d to g, inclusive. Denies the allegations contained in subparagraphs d to g, inclusive, of paragraph 5 of the petition.

h to m, inclusive. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraphs h to m, inclusive, of paragraph 5 of the petition.

n to z, inclusive. Denies the allegations contained in subparagraphs n to z, inclusive, of paragraph 5 of the petition.

aa. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph aa of paragraph 5 of the petition.

bb and cc. Denies the allegations contained in subparagraphs bb and cc of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's

determination be approved and the petitioner's appeal denied.

/s/ CHARLES W. DAVIS,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. Neblett, District Counsel; T. M. Mather, Special Attorney, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Aug. 19, 1952.

[Title of Tax Court and Cause No. 42,445.]

STIPULATION OF FACTS

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above entitled taxpayer, by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein stipulated, or to object to the introduction in evidence of any such facts on the grounds of immateriality or irrelevancy.

1. Petitioner is a California corporation, organized January 5, 1942, with its principal office at 3150 - 20th Avenue, San Francisco, California. At the date of filing its petition with The United States Tax Court, its office was at 3455 - 19th Avenue, San Francisco, California. It filed its income and excess profits tax returns for the calendar years 1942, 1943,

1944, and 1945, with the Collector of Internal Revenue in San Francisco, California. It kept its books with respect to sales of real estate on the installment method of accounting and it elected to report, and reported, and was entitled to report profits on sales of real estate on the installment method of accounting for each of the above years and for subsequent years.

2. Petitioner's principal operations for the years 1942, 1943, 1944, and 1945 consisted primarily in the construction and sale of individual residences. A few of the individual residences were sold for cash. Most of the individual residences were sold on the installment plan. The following summary reflects sales of individual residences on the installment plan and as completed sales not on the installment plan during each of the years 1942 to 1945, inclusive:

Year	Number of Houses	Number of Houses Sold on the Installment Plan	Number of Houses on which Entire Profit was Realized During the Year of Sale
1942,	356	349	7
1943,	88	88	
1944,	9	9	
1945,	91	91	
Total,	544	537	7

Residences sold on the installment plan were sold under a contract and purchasers were required to make small down payments and the balance of the purchase price was payable in monthly installments over a period of either twenty years or twenty-five years. During the year 1942, 347 residences which

were sold on the installment plan gave the purchasers twenty years in which to pay the balance due on the purchase price in monthly installments. The remaining two residences sold on the installment plan during the year 1942 and all residences sold on the installment plan during the years 1943, 1944, and 1945 gave the purchasers a period of twenty-five years in which to pay the purchase price in monthly installments. The level of payments which the purchaser was required to make during the first twenty-seven months was in all instances greater than the level of payments which the purchaser was required to make during the balance of the period. The exact language of the agreement pertaining to monthly payments is as follows:

"The purchase price for said property which purchaser agrees to pay and seller agrees to accept therefor is the sum of $........ payable as follows: $........ cash, receipt of which is hereby acknowledged; $........ per month payable on the ..... day of each and every month thereafter for a period of 27 months, (first period), and thereafter $............ per month payable on same day of each month until purchase price and interest are paid in full (second period)."

Petitioner's activities during the years 1942 and 1943 were confined primarily to the development of the subdivision known as Stonecrest. During the years 1943 and 1945, it acquired additional lands and developed subdivisions known as Westview Terrace and Edgewood Terrace. The development of all of these subdivisions consisted of the acquisition of

land, planning and subdividing the land, making necessary improvements, constructing individual residences on the improved lots and selling the individual residences.

4. Petitioner's acquisition of land and method of operation during the years 1942 to 1945, both inclusive, were as follows:

Petitioner purchased land from the partnership, Stoneson Bros., a co-partnership consisting of Henry S. Stoneson and Ellis L. Stoneson. The partnership had previously purchased an unimproved tract of property; the purchase price being financed partially by funds of the partnership but principally by a blanket deed of trust covering the entire tract in favor of the San Francisco Bank, securing a promissory note executed by each of the partners and their respective wives. Copies of the promissory note and the deed of trust pertaining to the subdivision Stonecrest are attached hereto and designated Exhibits 1-A and 1-B, respectively. The blanket deed of trust covered the cost of land not paid for with partnership funds and the estimated cost of basic improvements consisting of streets, curbs, sidewalks, sewers, fire hydrants, and gas and electricity connections servicing the entire property. Purchases of tracts of land which were developed into the subdivisions known as Westview Terrace and Edgewood Terrace were handled in the same manner as the purchase of land developed into the subdivision known as Stonecrest.

After the petitioner had made arrangements to acquire land previously purchased by the partner-

ship, Stoneson Bros., a subdivision map was prepared by the petitioner and immediately preceding its approval and recordation, title to the property was then transferred from the partnership to the petitioner by deed.

The procedure followed in the financing and sale of individual residences sold on the installment plan during each of the years 1942, 1943, 1944 and 1945 was as follows:

Through the San Francisco Bank and/or directly with the Federal Housing Administration, the petitioner then submitted for its information and approval and commitment for insurance the following documents: Master plan of house; subdivision information (F.H.A. Form No. 2084), Exhibit 3(b) hereof; description of materials (F.H.A. Form No. 2005), Exhibit 3(c) hereof; and Declaration of Restrictions, Exhibit 3(d) hereof.

After the foregoing met with the general approval of the Federal Housing Administration, it so advised the petitioner, as per Exhibit 3(e) hereof. Thereupon the petitioner, through The San Francisco Bank, applied for a specific construction loan (F.H.A. Form No. 2004 and 2004A), Exhibit 3(f) hereof, and upon securing F.H.A. commitment covering that specific loan (F.H.A. Form No. 2007), Exhibit 4(a) hereof, the bank granted the individual construction loan on each individual lot, in connection with which the petitioner executed a deed of trust note, Exhibit 5(a) hereof, and a deed of trust, Exhibit 5(b) hereof, which was then recorded by the bank. The original blanket deed of trust remains

outstanding on the rest of the tract but it was released as to the individual lot on which the specific loan was made, upon the payment out of the construction loan on account of the blanket loan of an agreed release price. The provisions relating to the release of lots are covered by a general agreement between the taxpayer and the bank, Exhibit 5 (c) hereof.

The petitioner then proceeded to the construction and completion of the house on the individual lot, inspection being made jointly by representatives of the bank and the petitioner for the purpose of securing progress payments on the construction loan.

Thereupon the petitioner proceeded to sell the individual houses, in all cases using a licensed real estate broker. When a sale was agreed upon, the purchaser signed a document entitled "California Real Estate Association Standard Form Deposit Receipt," Exhibit 6(a) hereof, furnished a Federal Housing Administration certificate of employment, Exhibit 6(b) hereof, and Mortgagee's Application for Mortgage Insurance (F.H.A. Form 2004 and 2004A) Exhibit 6(c) hereof.

Thereupon the Mortgagee's Application for Mortgage Insurance, Exhibit 6(c) hereof, and two certified copies of the Deposit Receipt, Exhibit 6(a) hereof, were transmitted to The San Francisco Bank, which submitted them, together with Federal Housing Administration Consent to Substitution of Mortgagors (F.H.A. Form No. 2210A) Exhibit 6(d) hereof, to the Federal Housing Administration.

If satisfactory to the F.H.A., it then executed

that portion of its Form 2210A, Exhibit 6(d) hereof, marked "(B) Preliminary Approval" and returned the same to the bank, which in turn transmitted it to the petitioner.

When the house was fully constructed and ready for occupancy, a Uniform Agreement of Sale, Exhibit 7(a) hereof, was executed by the purchaser and petitioner, and the purchaser also executed that portion of Exhibit 6(d) designated "(C) Purchaser's Certificate," a guarantee addressed to the bank, Exhibit 7(b) hereof, and a Quitclaim Deed, Exhibit 7(c) hereof.

The purchaser received only the following: A duplicate of the Uniform Agreement of Sale, Exhibit 7(a) hereof, a Monthly Payment Book, Exhibit 7(d) hereof, and a letter of transmittal, Exhibit 7(e) hereof.

All Uniform Agreements of Sale were originally identical with Exhibit 7(a) hereof. Subsequently, however, upon assignments of these contracts by the original purchasers the assigned contracts were changed to the forms attached hereto designated Exhibits 7(a-1) and 7(a-2), and all contracts in the year 1945 were in the form set forth in Exhibit 7(a-3).

Neither the bank nor the F.H.A. retained any executed copy of the Guarantee, Exhibit 7(b) hereof, nor of F.H.A. Form No. 2210A, when executed by the purchaser, Exhibit 6(d) hereof.

In no single case under Uniform Agreement of Sale, Exhibit 7(a), did the petitioner exercise its

option to deed the property to the purchaser. In no single case under any Agreement of Sale has the purchaser exercised an option to receive a deed prior to the payment in full of the total purchase price.

All monthly payments on contracts were made direct to the petitioner by the purchaser and all monthly payments due on loans were made direct by the petitioner to the bank, until the property was deeded to the purchaser, at which time the purchaser's contract account was closed and the unrealized profit applicable thereto was reported as income for that year.

Petitioner maintained records showing the sales price of each individual residence which it had sold, the down payment, the balance due from the purchaser (this being the sales price minus the down payment), the monthly payments due, the monthly payments received on each contract covering the principal, interest and trust funds (taxes and insurance), and the balance due from the purchaser after each monthly payment was received from the date each residence was sold on the installment plan to the date the installment contract was closed. The individual accounts covering amounts due from purchasers were never credited with any item other than cash payments from the date residences were sold on the installment plan to the date the installment contract was closed.

Petitioner's books and records maintained accounts reflecting the amount due The San Francisco

Bank on each loan which the bank made from the date the loan was made by the bank to the date the installment contract was closed and a deed was issued by petitioner conveying to the purchaser the residence covered by the deed of trust. The petitioner's procedure in handling bank loans was as follows:

The petitioner maintained individual accounts reflecting the balance due The San Francisco Bank on each loan. The accounts reflected the number of each loan, the amount of each loan, the monthly principal payments made on the loan, and the balance due the bank on each loan from the date the loan was granted to the date the installment contract was closed which covered the residence on which petitioner had executed a deed of trust as security for the loan. Petitioner received monthly statements from the bank showing monthly payments due on all outstanding loans, Exhibit 8(a). It checked the bank's monthly statements and summarized the amount due the Bank, Exhibit 8(b), and it then issued its check, Exhibit 8(c), in payment of the aggregate monthly payments due the bank on all outstanding loans. Exhibits 8(a), 8(b) and 8(c) cover loan transactions for the month of November, 1944 and they are typical of the manner in which loan transactions were handled in other months.

The San Francisco Bank carried all loans on its books and records as loans due from the petitioner from the date each individual loan was granted until the installment contract was closed pertaining to

the residence on which petitioner had executed a deed of trust as security for the loan. The bank grouped the loans into controls and each control accounted for loans which had exactly the same maturity date and the same payments due each month covering principal, interest, and trust funds (insurance and taxes). This made it unnecessary for the bank to post each individual loan grouped in a given control. The bank maintained individual accounts for all loans not falling in a control group. Each month, the bank forwarded the petitioner a statement reflecting details as to monthly payments due on loans in each control (interest, principal, and trust funds). The bank also sent monthly statements reflecting amounts due from petitioner on individual loans not grouped in a control. These monthly statements which the bank sent the petitioner reflected the amount of interest, principal, and trust funds (insurance and taxes) due for the month. Exhibit 8(a) is a copy of monthly statements which the bank sent petitioner for the month of November, 1944 and it is typical of statements for other months.

Every installment sales contract reflected on petitioner's books was closed by petitioner at the time the property covered by the contract was deeded to the purchaser. In substantially all cases, the property covered by an installment sales contract was not deeded to the purchaser until the purchaser paid the entire balance due on the installment sales contract and, concurrently with the receipt of such sum, petitioner paid the bank the balance due on the

loan which was secured by a deed of trust on the residence covered by the installment sales contract.

In a few cases, by special arrangement between the petitioner and the purchaser, under conditions not entitling the purchaser to a deed, the petitioner has nevertheless deeded the individual lot to the purchaser without requiring the payment of the purchase price in full. In each of such cases, which in the aggregate represent only a small percentage of the total number of contracts, the deed was issued for individual and personal reasons and not as of right on the part of either party. In such cases, the party receiving the deed made arrangements with the bank to assume the mortgage on the residence in question and paid petitioner any balance due on the installment sales contract in excess of the then balance due on the deed of trust. In every instance in which a deed was issued to a purchaser, such purchaser's installment sales contract was closed, and petitioner reported as income the entire amount of the unrealized profit for the year in which the installment account was closed and the deed was issued.

The purchasers of individual residences were only informed as to the amount of the loan secured by the deed of trust on the residence which they purchased on the date the purchasers executed the uniform agreements of sale, Exhibits 7(a), 7(a-1), 7(a-2), or 7(a-3), and at the time the purchaser's installment account was closed and they received deeds to the residences. The purchasers of residences on the installment plan were given no infor-

mation relating to the deeds of trust or loans secured by deeds of trust on residences which they purchased, or relating to payments which petitioner made on such loans at any other time.

When all lots in a subdivision were subject to individual deeds of trust, Henry Stoneson and Ellis L. Stoneson, the individual stockholders of the petitioner, and their wives, who had personally signed the original note and blanket deed of trust to the bank, were released from their personal responsibility thereon, so that the petitioner and petitioner only has at all times had the sole and primary liability to the bank on the deeds of trust with respect to houses covered by installment contracts which have not been closed, and during all of said period with respect to such deeds of trust, neither the purchaser nor any other party has had liability to the bank with respect to said loans. The outstanding liability on the deeds of trust covering individual residences sold on the installment plan during the years 1942, 1943, 1944, and 1945 were as follows at the close of each of the years 1942 to 1945, both inclusive:

December 31, 1942,	$1,389,872.34
December 31, 1943,	1,540,081.24
December 31, 1944,	1,294,709.57
December 31, 1945,	1,523,808.58

While each of the Uniform Agreements of Sale in anticipation of a possible transfer of the property to the purchaser before payment in full of the purchase price called for the concurrent execution of an assumption of the mortgage by the purchaser,

to be used if and when the election was exercised, the document actually signed was Exhibit 7(b) and, even had title passed before complete performance by the purchaser, the taxpayer would have remained primarily responsible to the bank for the full unpaid balance of the mortgage.

Inquiry has been made of the bank as to the conditions under which it would release the petitioner from its liability in the event of assumption thereof by the purchaser, and the petitioner has been informed authoritatively by George Meyer, Vice-President of the bank, that no agreement was ever made by the bank to give such release (apart from payment in full of the deed of trust) and that it was against the bank's policy, except under such condition, to give such a release, and that he will so testify if called upon.

The case of this Petitioner and the case of The Brookfield Corporation, Docket No. 42,445, involve essentially the same issue with respect to the determination of income realized on installment sales. The two cases have been consolidated for hearing and decision. Accordingly, the following facts common to each petitioner are consolidated in a single statement.

During the years 1942 to 1945, inclusive, the petitioners constructed and sold a total of 1,299 houses on the installment plan under the method hereinbefore described, summarized as follows (the statistical data on The Brookfield Corporation includes 49 deferred payment sales and 5 cash sales):

Year	Total	The Brookfield Corporation	The Stonecrest Corportion
1942,	467	118	349
1943,	732	644	88
1944,	9		9
1945,	91		91
Total,	1,299	762	537

The date each petitioner was required to commence payment to the bank on an individual loan was determined at the time each loan was granted. Such date was generally the first of the fourth or the first of the sixth month following the date the loan was authorized. The first payment, and all subsequent payments were always due on the first day of a month and each payment was due according to the original loan agreement regardless of whether the house on which the deed of trust securing the loan had been completed and/or sold. The purchaser of any specific house was required to make his first monthly installment payment to petitioner on the first day of the month following the month the house was completed in the event the sale took place before completion, or the first day of the month following the month of sale if the sale took place after completion. There was no intended correlation between the commencement of payments due from purchasers on homes sold under installment contracts and the commencement of payments by petitioner to the bank on its loans secured by deeds of trust on the properties sold on the installment plan. Of the 1,299 installment sales referred to above, the ledger sheets with reference to 9 accounts which

have been closed have been misplaced and are currently not available. As shown below, of 1,290 installment sales for which information is currently available, the petitioners in 807 cases were required to make payments on their loans secured by deeds of trust on the 807 houses at least one month before installment payments commenced on installment contracts covering sales of the 807 houses. Petitioners were entitled to receive payments on 227 installment contracts covering sales of houses at least one month before they were obligated to make payments on their loans secured by deeds of trust on the 227 houses, and in 256 cases the first payments petitioners were entitled to collect on installment contracts were due on the same date petitioners were required to make payments on loans secured by deeds of trust on the 256 houses.

Number of jobs on which first payment on bank loan secured by a deed of trust on a house was due at least one month before first payment was due on installment contract covering sale of house: The Brookfield Corporation, 531, The Stonecrest Corporation, 276, Total: 807.

Number of jobs on which first payment on installment contract covering sale of a house was due at least one month before first payment was due on bank loan secured by deed of trust on the house: The Brookfield Corporation, 79, The Stonecrest Corporation, 148, Total: 227.

Number of jobs on which first payment on bank loan secured by deed of trust on a house and first payment on installment contract covering sale of

house was due on the same day. The Brookfield Corporation, 143, The Stonecrest Corporation 113, Total: 256. The Brookfield Corporation 753, The Stonecrest Corporation 537, Total 1,290.

In none of the 807 cases in which the petitioners were obligated to make payments on the loans secured by deeds of trust on the houses at least one month before purchasers were required to make monthly installment payments on the purchase price of the houses was any arrangement made so as to have the respective number of payments on the purchase price coincide with the number of payments required on loans secured by deeds of trust on the 807 houses. In none of the 207 cases in which the purchaser was required to make monthly installment payments on the purchase price at least one month before petitioners were obligated to make monthly payments on the loans secured by deeds of trust on the 207 houses were arrangements made so as to have the number of payment on the purchase price of the 207 houses coincide with the number of payments petitioners were required to make on the loans secured by deeds of trust on the 207 houses. In the event purchasers of houses on the installment plan made all payments on the due dates, and petitioners made all payments on their loans secured by deeds of trust on the houses in question which were sold on the installment plan on the due dates, in none of the 1,034 cases would the balances due on the purchase price of any of the houses ever correspond with the balances petitioners owed on loans secured by deeds of trust on the 1,034 houses

during the entire life of the installment sales agreement with the exception that other than in the few cases referred to in the first paragraph on page 10 hereof purchasers would be required to pay the balances due on installment contracts in full and petitioners would be required to pay loans secured by deeds of trust in full on the date an installment contract was closed and a deed issued to the purchaser.

In the case of petitioner Stonecrest of the 349 houses sold on the installment plan during the year 1942, the purchase price of 80 houses was receivable in monthly installments over a period of 20 years, and petitioner's loans secured by deeds of trust on the 80 houses in question were payable in monthly installments over a period of 25 years.

In the case of 8 of the foregoing 80 sales the purchaser was not required to commence monthly payments on the installment contracts for at least one month after the petitioner was obligated to commence monthly payments on the loans secured by deeds of trust on the 8 houses. In 56 of the 80 cases the purchasers were required to commence monthly installment payments on the purchase price at least one month before the petitioner was obligated to commence payments on loans on deeds of trust secured by the 56 houses. In 16 of the 80 cases, the date the purchasers were required to commence first payments on the installment contracts and the date petitioner was obligated to make the first monthly payments on loans secured by deeds of trust on the 16 houses coincided. Aside from the un-

balance between the amount due on the purchase price of 64 of said houses and the balance due on loans secured by deeds of trust on the said 64 houses in the 64 cases where the date of the first monthly installment payment due from purchasers did not coincide with the first date on which petitioner was required to commence monthly payments on loans secured by deeds of trust on the 64 houses, in all of the 80 cases there was a further lack of balance since purchasers of said houses were required to pay the total purchase price in monthly installments over a period of 20 years while petitioner by the terms of loans secured by deeds of trust on such houses was allowed to discharge the loans in monthly installments over a period of 25 years.

Assuming both parties met their respective obligations on the due dates, only in those cases in which the life of the installment contract and the life of the loan secured by a deed of trust on the property sold were the same and the due date of the first payment on the installment sales contract coincided with the due date of the first payment on the loan secured by a deed of trust on the house sold on the installment plan would the balance of such loans ever coincide with the balances due on the purchase price of the houses during the entire life of the sales contract. As previously explained, in 256 of 1,290 cases, the said respective due dates coincided. Since in 16 cases of the said 256 cases the life of the loans secured by deeds of trust was 25 years and the life of the installment contracts was 20 years, only in 240 of the 1,290 cases would the balance of the loans

and the balance of the purchase price ever coincide, assuming both parties met their respective obligations on the due dates.

The purchasers made down payments and monthly payments to petitioners on installment contracts only in cash, by check, draft, or money order. In no month did all the purchasers make installment payments to the petitioners on the dates payments were due on all installment contracts. In each month the petitioners made payments on all loans secured by deeds of trust on houses sold on the installment plan prior to the dates all of the purchasers had made payments on installments due during the month on outstanding installment contracts. Illustratively, the number of payments received in each month of the years 1944 and 1945 by each of the petitioners covering delinquencies of over one month were as follows:

	The Brookfield Corporation		The Stonecrest Corporation	
	1944	1945	1944	1945
January	93	217	52	61
February	120	168	55	51
March	136	151	52	43
April	147	149	49	52
May	132	219	43	43
June	135	152	33	29
July	127	109	47	40
August	149	106	34	25
September	121	85	53	39
October	128	96	41	20
November	147	82	39	19
December	132	113	23	19

Exhibits 9 (a) and 9 (b) with respect to petitioner Stonecrest reflect all installment contracts

outstanding on the first day of each month for each month of each of the years 1944 and 1945; all petitioners loans outstanding on such dates which were secured by deeds of trust on houses sold under such installment contracts, the dates on which petitioner made monthly payments to the bank on all of such outstanding loans and the number of purchasers who had not made current monthly installment payments to petitioner at the time petitioner made its said current monthly loan payment to the bank.

Exhibits 9 (c) and 9 (d) with respect to petitioner Brookfield reflect all installment contracts outstanding on the first day of each month for each month of each of the years 1944 and 1945; all petitioners loans outstanding on such dates which were secured by deeds of trust on houses sold under such installment contracts, the dates on which petitioner made monthly payments to the bank on all of such outstanding loans and the number of purchasers who had not made current monthly installment payments to petitioner at the time petitioner made its said current monthly loan payment to the bank.

During each of the years 1942, 1943, 1944, and 1945, each of petitioners deposited all funds which they received including all collections from individuals purchasing houses on the installment plan in their respective corporate bank accounts. Separate or special bank accounts were never set up by either petitioner for any portion of any of the payments collected from individuals who had purchased houses on the installment plan, and no por-

tion of any payment received from any installment purchaser was ever segregated, set aside, appropriated or earmarked for payment on installment loans. Each petitioner made payment of loans secured by deeds of trust on houses sold on the installment plan out of its general funds, which comprised all funds of every nature whatsoever received by each petitioner.

5. The sales price, cost and profit to be realized pertaining to houses which petitioner Stonecrest sold on the installment plan and as completed sales were as follows for each of the years 1942 to 1945, both inclusive:

	Installment Sales			Completed Sales		
r	Sales Price	Cost	Profit to be Realized	Sales Price	Cost	Profit Realized
2,....	$1,561,882.28	$1,226,285.33	$335,596.95	$31,450.00	$24,691.83	$6,758.17
3,....	452,450.00	347,663.12	104,786.88			
4,....	47,250.00	35,629.11	11,620.89			
5,....	591,500.00	507,871.00	83,629.00			
al,	$2,653,082.28	$2,117,448.56	$535,633.72	$31,450.00	$24,691.83	$6,758.17

6. The payments which the petitioner Stonecrest received during each of the years 1942, 1943, 1944, and 1945 on installment sales of real estate made during each of those years, together with the payments received during each of the years 1943, 1944, and 1945 on installment sales made prior to the commencement of the year 1943, the year 1944, and the year 1945, are summarized as follows:

A. Installment payments actually received in cash on installment sales of 349 houses made during

the year 1942: (a) Cash down payment on 1942 installment sales, $72,692.00. (b) Installment payments received subsequent to date of sale on 1942 installment sales, 1942: $27,624.99. 1943: $316,831.35. 1944: $251,574.55. 1945: $196,220.04.

B. Installment payments actually received in cash on installment sales of 87 houses and 1 lot made during the year 1943: (a) Cash down payment on 1943 installment sales, $25,250.00. (b) Installment payments received subsequent to date of sale on 1943 installment sales, 1943: $3,266.80. 1944: $40,607.13. 1945: $83,165.12.

C. Installment payments actually received in cash by petitioner on installment sales of 9 houses during 1944: (a) Cash down payment on 1944 installment sales, $2,400.00. (b) Installment payments received subsequent to date of sale on 1944 installment sales, 1944: $2,732.19. 1945: $3,768.02.

D. Installment payments actually received in cash by petitioner on installment sales of 91 houses during 1945: (a) Cash down payment on 1945 installment sales, $73,300.00. (b) Installment payments received subsequent to date of sale on 1945 installment sales, 1945: $2,953.05.

E. Total installment payments actually received in cash by petitioner on installment sales during the years 1942 through 1945, 1942: $100,316.99. 1943: $345,348.15. 1944: $297,313.87. 1945: $359,406.23.

7. Petitioner Stonecrest reported that it realized taxable income from installment sales of real estate in its income and excess profits tax returns for the years 1942, 1943, 1944 and 1945, as follows:

Taxable profit realized on installment sales made during 1942, and on collection on such sales received in 1943, 1944 and 1945: 1942: $21,554.26. 1943: $68,-233.14. 1944: $59,808.92. 1945: $37,117.31.

Taxable profit realized on installment sales made during 1943, and on collections on such sales received in 1944 and 1945, 1943: $6,817.41. 1944: $9,621.83. 1945: $19,096.73.

Taxable profit realized on installment sales made during 1944, and on collections on such sales received in 1946, 1944: $1,262.03. 1945: $926.72.

Taxable profit realized on installment sales made during 1945, 1945: $10,781.21.

Total; 1942: $21,554.26. 1943: $75,050.55. 1944: $70,692.78. 1945: $67,921.97.

If the Tax Court finds in favor of petitioner Stonecrest and determines that mortgages subsisting at the dates of sales of real estate on the installment plan, to the extent such mortgages did not exceed petitioner Stonecrest's bases of the properties sold on the installment plan are not required to be deducted from the sales price in determining the contract price, and that the excess of such subsisting mortgages at the dates of sale over the said bases is not required to be included as part of the initial payments received during the year of sale, then the correct amount of income on houses sold on the installment plan, which petitioner Stonecrest realized and which it was required to report in its income and excess profits tax returns for each of the years 1942, 1943, 1944 and 1945 was, respectively as follows, to wit:

10. The aggregate amount of loans secured by Deeds of Trust on houses sold at date of sale of all houses sold on the installment basis during each of the years 1942, 1943, 1944 and 1945, amounted respectively to $1,396,000.00, $384,400.00, $39,150.00 and $491,400.00. The loans in question are all designated as "* Mortgages" on the schedule on Page 24 of this stipulation. During each of the years 1942, 1943 and 1944, the amount of the mortgage on each house sold on the installment plan was in excess of the cost of such house; the cost of each house sold on the installment plan during the year 1945 was in excess of the mortgage on such house.

11. The deferred installment payments referred to in Paragraph 2 of Pages 2 and 3 of this stipulation and which are referred to in other paragraphs herein bore interest at the rate of 6% per annum on that portion of the purchase price specified in Exhibit 7(a) payable during the first 27 months (the first period) and at the rate of 4½% per annum on that portion of such purchase price receivable payable during the remaining term of the contract.

This interest arrangement was modified with respect to installment contracts receivable arising in connection with the execution of contract Exhibit 7(a)-3. Under the latter contracts installments payable equal to the balance of the purchase price due from the purchaser of a house in excess of the original amount of the loan secured by a Deed of Trust on such house bore interest at the rate of 6% per annum and the remaining portion due on said purchase price bore interest at the rate of 4½% per

annum. Each payment required under the installment contract included a payment due on the deferred portion of the sales price, interest thereon at the rate or rates specified and a payment equal to estimated taxes and insurance applicable to each house that was sold on the installment plan.

The level of payments which purchasers were required to make to petitioners during the first 27 months (the first period) on the installment contract were, in all instances, greater than the level of payments which purchasers were required to make to petitioner during the remaining term of the installment contracts. The term of all installment contracts was either for a 20-year period or a 25-year period. The level of payments collected during the period the first 27 installment payments under each contract over the level of payments prevailing during the remaining term of the contract amount to a sum equal to the excess of the balance of the purchase price due from the purchasers over the original amount of the loan secured by a deed of trust on each property sold on the installment plan, together with interest on the principal amount of such excess at the rate of 6% per annum.

12. The "other collections on the contract price" as set forth in the schedule on Page 24, showing the Commissioner's computation of profit realized on installment sales do not include all collections on installment contracts. The "other collections on contract price" set forth in such schedule include only the principal portion of the level of payments collected during the period the first 27 installment pay-

ments are received over the level of payments prevailing during the remaining term of the contract as set forth in Paragraph 11 above. No other part of payments which petitioner collected from the purchaser, either during the first 27 months or in any subsequent month, were included by the Commissioner in "other collections on contract price."

13. Whenever a purchaser under any installment contract paid petitioner the full sum designated in the contract as the purchase price, such purchaser was entitled to receive a deed to the property free and clear of the Deed of Trust.

14. Under the petitioner's method of accounting, which it followed in determining income realized on installment sales, for both accounting and tax purposes, income on installment sales was recognized during each year in which collections were received on such sales and the amount of income it recognized as realized represented that portion of payments received from the purchasers during each year on a given installment sale which the gross profit to be realized on that sale when payments were completed bore to the total price of the residence sold on the installment plan. The petitioner reported the sales price as being the contract price and it did not diminish the sales price of the residence sold in the amount of the subsisting loans secured by a Deed of Trust on the residences in question at the date of sale which was not in excess of the cost of the residence sold. During the years 1942, 1943, 1944 and 1945, petitioner sold, respectively, 349, 88, 9 and 91 residences on the install-

ment plan under contracts which in many cases gave the purchasers a period of 25 years in which to pay the purchase price in monthly installments, and in some cases a period of only 20 years.

Dated 11-1-54.

/s/ DANIEL A. TAYLOR,
Attorney for Commissioner of Internal Revenue.

Dated Nov. 1, 1954.

/s/ BERT F. RABINOWITZ,
Counsel for Petitioner.

Dated Nov. 1, 1954.

/s/ SCOTT H. DUNHAM,
Certified Public Accountant,
Of Counsel.

[Endorsed]: T.C.U.S. Filed Nov. 4, 1954.

[Title of Tax Court and Cause No. 42,446.]

STIPULATION OF FACTS

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above entitled petitioner, by their respective undersigned attorneys, that the following facts shall be taken as true, provided, however, that this stipulation does not waive the right of either party to introduce other evidence not at variance with the facts herein

stipulated, or to object to the introduction in evidence of any such facts on the grounds of immateriality or irrelevancy.

1. Petitioner is a California corporation, organized February 27, 1942, with its principal office at 3150 - 20th Avenue, San Francisco, California. At the date of filing its petition with The United States Tax Court, its office was at 3455 - 19th Avenue, San Francisco, California. It filed its income and excess profits tax returns for the calendar years 1942, 1943, 1944 and 1945, with the Collector of Internal Revenue in San Francisco, California. It kept its books and records with respect to most of the sales of real estate on the installment method of accounting and it elected to report, and reported, and was entitled to report profits on sales of such real estate on the installment method of accounting for each of the above years and for subsequent years. It kept its books with respect to other sales of real estate on the accrual basis and it elected to report and reported and was entitled to report profits or losses on such sales of real estate as deferred payment sales not on the installment basis.

2. Petitioner's operations for the years 1942 to 1945 and for all subsequent years have been confined solely to the development and liquidation of a single subdivision in Alameda County known as Brookfield. Petitioner acquired land, planned and subdivided the land, made necessary subdivision improvements, constructed individual residences on the improved lots, and sold the residences. The property was developed and the residences were constructed

and sold during the years 1942 and 1943, and petitioner's activities for the years 1944, 1945, and all subsequent years have been confined primarily to servicing the subdivision and the residences erected on building lots therein which it sold, collecting amounts due from purchasers of the residences, paying principal and interest on its indebtedness to The San Francisco Bank, all of which consists of individual loans secured by deeds of trust on individual residences sold, maintaining books and records, and undertaking other necessary activities in connection with the development and liquidation of the Brookfield subdivision.

Most of the residences were sold on the installment basis. Some of the residences were sold on a long-term payment plan and were classified as deferred payment sales. A few of the residences were sold for cash. The following summary reflects sales of individual residences and the method used by petitioner to record and report profits or losses attributable to the residences sold:

Year: 1942. Number of Houses Sold: 118. Number of Houses Sold for Cash: None. Number of Houses Sold Under Installment Contracts on Which Petitioner Elected to Report Profits and Reported Profits on Such Houses: As Installment Sales: 103. As Deferred Notes Not on the Installment Basis: 15.

Year: 1943: Number of Houses Sold: 644. Number of Houses Sold for Cash: 5. Number of Houses Sold Under Installment Contracts on Which Petitioner Elected to Report Profits and Reported Profits on Such Houses: As Installment Sales: 605.

As Deferred Notes Not on the Installment Basis: 34.

Totals: Number of Houses Sold: 762. Number of Houses Sold for Cash: 5. Number of Houses Sold Under Installment Contracts on Which Petitioner Elected to Report Profits and Reported Profits on Such Houses: As Installment Sales: 708. As Deferred Notes Not on the Installment Basis: 49.

The residences which petitioner sold during the years 1942 and 1943 on the installment plan and on the deferred payment plan were sold under identical type of contract under which purchasers were required to make small down payments on the purchase price at the date of sale and the balance of the purchase price was payable in monthly installments over a period of 25 years.

The tax and accounting treatment of the deferred payment sales, which were carried on the petitioner's records as completed sales and are sometimes referred to herein as completed sales, reflected that it realized profits on such sales for the years 1942 and 1943 in the respective amounts of $14,705.50 and $39,615.72, this being the excess of the sales price of the completed sales over the cost and tax basis of the houses which were sold on this basis. The attached Exhibit 1-A reflects pertinent details relating to completed sales made during the year 1942. The exhibit reflects the sales price of each house, the cost, the excess of the sales price over cost, the down payment, the amount of the sales price evidenced only by a contract receivable, and the collections on each contract receivable during the year of sale and during each of the years 1943,

1944 and 1945. The attached Exhibit 1-B reflects similar details relating to completed sales made during the year 1942. Petitioner reported the profits as reflected above in its income and excess profits tax returns for the years 1942 and 1943.

Under the petitioner's method of accounting, which it followed in determining income realized on installment sales, for both accounting and tax purposes, income on installment sales was recognized during each year in which collections were received on such sales and the amount of income it recognized as realized represented that portion of payments received from the purchasers during each year on a given installment sale which the gross profit to be realized on that sale when payments were completed bore to the total price of the residence sold on the installment plan. The petitioner reported the sales price as being the contract price and it did not diminish the sales price of the residence sold in the amount of the subsisting loans secured by a Deed of Trust on the residences in question at the date of sale which was not in excess of the cost of the residence sold. During the years 1942 and 1943, petitioner sold, respectively, 103 and 605 residences on the installment plan under contracts which gave the purchasers a period of 25 years in which to pay the purchase price in monthly installments.

The level of payments which the purchaser was required to make during the first 27 months was in all instances greater than the level of payments which the purchaser was required to make during

the balance of the period. The exact language of the agreement pertaining to monthly payments is as follows:

"The purchase price for said property which purchaser agrees to pay and seller agrees to accept therefor is the sum of $...... payable as follows: $...... cash, receipt of which is hereby acknowledged; $...... per month payable on the .... day of each and every month thereafter for a period of 27 months, (first period), and thereafter $...... per month payable on same day of each month until purchase price and interest are paid in full (second period)."

Under all contracts covering installment sales for the years 1942 and 1943, petitioner was entitled to receive collections from purchasers on residences sold on monthly installments over a 25-year period, or a period of 300 months, unless the contract was closed prior to the maturity date of the last monthly payment due thereon. Installment contracts were always closed when deeds were issued to purchasers. In most cases when installment contracts were closed, petitioner collected from the purchaser the balance then due on the installment contract and it issued a deed to the purchaser conveying title to the property free and clear of all encumbrances other than taxes assessed which were not then due and payable.

In a few cases, when an installment contract was closed, petitioner collected from the purchaser only the amount due from the purchaser in excess of the balance due by petitioner to The San Francisco

Bank on the loan secured by a deed of trust on the residence in question and the purchaser assumed the balance due on the loan and made arrangements with the bank to make all future payments due on such loan. The petitioner then issued a deed conveying the residence to the purchaser subject to the assumed loan and taxes assessed which were not then currently due and payable. In all instances when an installment contract was closed, petitioner closed the unrealized profit on such contract to realized profit and it reported such realized profits in its income and excess profits tax returns for the year in which the contract was closed.

The facts set forth in the stipulation of facts filed by petitioner Stonecrest, which are contained in Pages 3 to 20, both inclusive, including all exhibits referred to therein, apply to this petitioner Brookfield except where it is specifically stated that the facts are applicable only to the petitioner Stonecrest. The exhibits attached to the aforesaid stipulation filed by petitioner Stonecrest and designated as Exhibits 3(b), 3(c), 3(d), 3(e), 3(f), 4(a), 5(a), 5(b), 5(c), 6(a), 6(b), 6(d), 7(a), 7(a-1), 7(a-2), 7(a-3), 7(b), 7(c), 7(d), 7(e), 8(a), 8(b), 8(c), and 9(a), 9(b), 9(c), 9(d), are identical to the corresponding forms or agreements used by this petitioner, with the exception that the name Brookfield was substituted for the name Stonecrest in the documents with respect to agreements or business forms used by this petitioner.

The following exceptions from the facts set forth in the case of petitioner Stonecrest should be noted:

A. Petitioner Brookfield purchased undeveloped land from a partnership, consisting of Henry Stoneson, Ellis L. Stoneson, and Albert Bernhardt. Circumstances relating to the acquisition of undeveloped land and the financing and subdividing the land and the circumstances relating to the construction and financing of individual residences are identical with the circumstances relating to the acquisition, developing, and financing by petitioner Stonecrest, with the exception that in the case of the petitioner Brookfield, Henry Stoneson, Ellis L. Stoneson, and Albert Bernhardt, the Stockholders of petitioner Brookfield, and their respective wives were required personally to guarantee each individual note secured by individual deeds of trust on the houses constructed and sold and these individuals were never relieved from their secondary liability on such loans until the loans were either paid in full or, in the few cases referred to, assumed by the purchasers.

B. At all times during the years 1942, 1943, 1944, and 1945 and up to the present time, the petitioner, Brookfield has had primary liability to The San Francisco Bank with respect to every loan which it obtained which was secured by a deed of trust on a residence and its Stockholders and their wives have had secondary liability on such loans and neither the purchaser of the house encumbered by the loan secured by the deed of trust nor any party other than petitioner Brookfield, its Stockholders, and their wives, have had any liability to the bank with respect to such loans from the date each such loan

was granted to the date each such loan was paid in full, or assumed in those few cases where purchasers assumed the balance due to the bank on such loans at the time their contracts were closed and they obtained a deed to the property.

The outstanding liabilities on deeds of trust on individual residences sold during the years 1942 and 1943 on the installment basis, and as deferred payment sales on which petitioner Brookfield was primarily liable and on which its Stockholders and their wives were secondarily liable as guarantors, were as follows at the close of each of the years 1942 to 1953, both inclusive:

December 31, 1942,	$2,002,000.00
December 31, 1943,	2,933,090.84
December 31, 1944,	2,823,621.25
December 31, 1945,	2,583,797.20
December 31, 1946,	1,531,873.19
December 31, 1947,	920,060.48
December 31, 1948,	743,534.74
December 31, 1949,	627,156.52
December 31, 1950,	525,525.35
December 31, 1951,	462,094.60
December 31, 1952,	376,424.51
December 31, 1953,	304,897.65

4. At the close of the year 1944, petitioner in error closed out 105 installment sales contracts covering sales which it had made on the installment plan during the years 1942 and 1943 and its books of account and income and profits tax return for the calendar year 1944 reflected a profit of $75,-833.18 as realized on the installment sales contracts which were closed out in error. Petitioner did not collect the balance due on the 105 install-

ment contracts during the year 1944 and none of the individuals who had purchased homes on the installment basis assumed a loan covered by a single deed of trust on any one of the 105 houses during the year 1944. During the year 1945, petitioner collected $24,404.34 on the 105 installment sales contracts which it in error closed out during the year 1944 and, on the petitioner's method of accounting for profits realized on installment sales, petitioner realized a profit during the year 1945 on collections during that year on the contracts which were erroneously closed out during the year 1944.

If the Tax Court finds in favor of this petitioner and determines that mortgages subsisting at the dates of sale of real estate on the installment plan to the extent that such mortgages did not exceed petitioner's basis of the properties sold on the installment plan were not required to be deducted from the sales price in determining the contract price, and that the excess of such subsisting mortgages at the dates of sale over the said basis is not required to be included as a part of the initial payments received during the year of sale, then petitioner's income for the year 1944 as reported on its income and excess profits tax returns for that year was overstated in the amount of $75,833.18 and the income which it realized during the year 1945 and which it reported on its income and excess profits tax return for the year 1945 was understated in the amount of $5,685.02.

5. If the Tax Court holds against the petitioner

and determines that mortgages subsisting at the dates of sales of real properties to the extent they did not exceed petitioner's basis of the properties sold on the installment plan, are required to be deducted from the sales price in determining the contract price, and that the excess of such subsisting loans over such basis is required to be included as part of the initial payment received during the year of sale, together with such portion of other collections which the Commissioner recognizes as being received by petitioner, constitutes income in the respective amounts of 100% of such excess mortgages and such recognized collections for the years 1942 and 1943, then petitioner will sustain net operating losses during each of the years 1946 and 1947 and, as a result, it will be entitled to carry the net operating loss for the year 1946 back to the year 1944 and it will be permitted to carry the net operating loss for the year 1947 back to the year 1945. The net operating loss deduction will give rise to unused excess profits credit carry-backs to the years 1942 and 1943. The amount of the net operating loss deduction allowable in the year 1944 will give rise to an unused excess profits credit carry-back which may be carried to the year 1942 and the net operating loss deduction for the year 1945 will give rise to an unused excess profits carry-back which may be carried to the year 1943. It is agreed that in the event the Tax Court renders a decision against the petitioner that the net operating loss carry-backs and resulting unused excess profits credit carry-backs resulting from the

determination of petitioner's income for the years 1946 and 1947 in accordance with the decision of the Tax Court will be duly taken into consideration in determining the deficiencies in income and excess profits taxes due from petitioner for the years 1942, 1943, 1944 and 1945.

6. The deferred installment payments referred to in the last paragraph on Page 4 and the first paragraph on Page 5 of this stipulation and which are referred to in other paragraphs herein bore interest at the rate of 6% per annum on that portion of the purchase price specified in Exhibit 7(a) payable during the first 27 months (the first period) and at the rate of 4½% per annum on that portion of such purchase price receivable payable during the remaining term of the contract.

This interest arrangement was modified with respect to installment contracts receivable arising in connection with the execution of contract Exhibit 7(a)-3. Under the latter contracts installments payable equal to the balance of the purchase price due from the purchaser of a house in excess of the original amount of the loan secured by a Deed of Trust on such house bore interest at the rate of 6% per annum and the remaining portion due on said purchase price bore interest at the rate of 4½% per annum. Each payment required under the installment contract included a payment due on the deferred portion of the sales price, interest thereon at the rate or rates specified and a payment equal to estimated taxes and insurance applicable to each house that was sold on the installment plan.

The level of payments which purchasers were required to make to petitioners during the first 27 months (the first period) on the installment contract were, in all instances, greater than the level of payments which purchasers were required to make to petitioner during the remaining term of the installment contracts. The term of all installment contracts was for a period of 25 years. The level of payments collected during the period the first 27 installment payments under each contract over the level of payments prevailing during the remaining term of the contract amount to a sum equal to the excess of the balance of the purchase price due from the purchasers over the original amount of the loan secured by a Deed of Trust on each property sold on the installment plan, together with interest on the principal amount of such excess at the rate of 6% per annum.

7. The sales price, cost and profit to be realized on houses which petitioner sold on the installment basis were as follows for each of the years 1942 to 1945, inclusive:

Year	Sales Price	Cost	Profit to be Realized
1942, ...	$ 450,800.00	$ 350,848.90	$ 99,951.10
1943, ...	2,714,500.00	2,014,011.65	700,488.35
Total, ...	$3,165,300.00	$2,364,860.55	$800,439.45

8. The sales price, cost, portion of the sales price collected in cash at the time of sale, the portion of the sales price deferred and evidenced by contracts receivable from the purchaser on houses

sold as deferred payment sales which petitioner did not elect to report on the installment basis for each of the years 1942 and 1943, inclusive, are as follows:

Year: 1942—Sales price: $65,800.00. Cost: $51,-094.50. Portion of sales price collected in cash at time of sale: $1,900.00. Portion of sales price deferred and evidenced by contracts receivable from purchasers: $63,900.00.

Year: 1943—Sales price: $152,800.00. Cost: $113,-184.28. Portion of sales price collected in cash at time of sale: $5,100.00. Portion of sales price deferred and evidenced by contracts receivable from purchasers: $147,700.00.

Total sales price: $218,600.00. Total cost: $164,-278.78. Total portion of sales price collected in cash at time of sale: $7,000.00. Total portion of sales price deferred and evidenced by contracts receivable from purchasers: $211,600.00.

9. The sales price, cost and profit which the petitioner realized on cash sales of homes which were made during the year 1943, are as follows:

Year	Sales Price	Cost	Profit Realized
1943,	$22,050.00	$16,644.73	$5,405.27

10. The following summary reflects the number of houses petitioner sold during the years 1942 and 1943, with respect to which it elected to report profits on the installment basis. The schedule also reflects the sales price of the houses in question, the cost of the houses sold, the total amount of the profit to be realized on the installment basis, the

down payment which petitioner collected in cash on the properties sold on the installment basis during each year and other collections on the installment sales which petitioner received during the years 1942, 1943, 1944 and 1945, and the total payments on installment sales which petitioner received during each of the years 1942 to 1945, both inclusive:

Number of houses sold on the installment basis: 1942: 103; 1943: 605.

Total sales price of houses sold on the installment basis: 1942: $450,800.00; 1943: $2,714,500.00.

Cost of property sold: 1942: $350,848.90; 1943: $2,014,011.65.

Profit to be realized: 1942: $99,951.10; 1943: $700,-488.35.

Down payment received on property sold on installment basis: 1942: $14,300.00; 1943: $100,150.00.

Other collections on installment sales: 1942: $102.75; 1943: $107,123.64; 1944: $205,914.26; 1945: $297,906.22.

Total payments on installment sales: 1942: $14,-402.75; 1943: $207,273.64; 1944: $205,914.26; 1945: $297,906.22.

11. If the Tax Court finds in favor of petitioner and determines that mortgages subsisting at the dates of sales of real estate on the installment plan, to the extent such mortgages did not exceed petitioner's bases of the properties sold on the installment plan are not required to be deducted from the sales price in determining the contract price,

and that the excess of such subsisting mortgages at the dates of sale over the said bases is not required to be included as part of the initial payments received during the year of sale, then the correct amount of income on houses sold on the installment plan, which petitioner realized and which it was required to report in its income and excess profits tax returns for each of the years 1942, 1943, 1944 and 1945, and which should be taken into consideration in determining its income tax liability for each of the years, is respectively as follows, to-wit:

1942,	$ 3,193.07
1943,	50,616.17
1944,	51,833.78
1945,	75,918.03

The profit for the year 1945 amounting to $75,-918.03 includes the profit for that year amounting to $5,685.02, referred to on Page 9 of this stipulation, which petitioner should have reported in its income and excess profits tax returns for the year 1945.

12. If the Tax Court holds against the petitioner and determines that mortgages subsisting at the dates of sales of real properties to the extent they did not exceed petitioner's basis of the properties sold on the installment plan are required to be deducted from the sales price in determining the contract price, and that the excess of such subsisting mortgages over such basis is required to be included as part of the initial payment received during the year of sale, together with that portion of

other collections which the Commissioner recognizes as being received by petitioner constitutes income in the respective amounts of 100% of such excess mortgages and such recognized collections for the years 1942, 1943, 1944, and 1945, then it is stipulated and agreed that the following schedule reflects the correct determination of income petitioner realized on installment and all other sales of real estate for each of the years 1942 to 1945, and the schedule also reflects the increase in profit realized by petitioner over the realized profit reported by the petitioner for each of the years 1942 to 1945, inclusive.

	1942	1943	1944	1945
Total sales	$516,600.00	$2,889,350.00	None	None
Cost of property sold	401,943.40	2,143,840.66		
Profit to be realized	$114,656.60	$ 745,509.34		
Selling price	$516,600.00	$2,889,350.00		
Less: Mortgages* (limited to cost of property sold)	401,943.40	2,143,840.66		
Contract price	$114,656.60	$ 745,509.34		
Ratio of profit to be realized to contract price	100%	100%		

The Brookfield Corporation—Supporting Statement

	1942	1943	1944	1945
*Mortgages	$462,000.00	$2,552,300.00		
Mortgages on property sold	462,000.00	2,552,300.00		
Less: Cost of property sold	401,943.40	2,143,840.66		

	1942	1943	1944	1945
Mortgages in excess of cost of property	$ 60,056.60	$ 408,459.34		
Down payment received on property sold	16,200.00	100,600.00		
Other collections on contract price	101.98	70,923.16*	$120,435.11a	$80,725.64b
Total realized profit applicable to current year	$ 76,358.58	$ 579,982.50	$120,435.11	$80,725.64
Realized profit reported	17,898.57	95,637.15	127,666.96	70,233.01
Increase in realized profit	$ 58,460.01	$ 484,345.35	($ 7,231.85)	$10,492.63

* Includes collections received on 1942 contract price. Reportable 100 per cent.

(a) 1944 collections on 1942 and 1943 contract price. Reportable 100 per cent.

(b) 1945 collections on 1942 and 1943 contract price. Reportable 100 per cent.

13. The Commissioner and the petitioner executed agreements pursuant to Section 276(b) of the Internal Revenue Code of 1939, as amended, to extend beyond the time prescribed in Section 275 thereof, the time within which the Commissioner might assess the tax for the year 1944 and the year 1945, as follows:

Year	Date of Agreement	Time for Assessment Extended to
1944	12/29/47	6/30/49
"	3/25/49	6/30/50
"	4/18/50	6/30/51
"	2/27/51	6/30/52
1945	1/25/49	6/30/49
"	3/25/49	6/30/50
"	4/18/50	6/30/51
"	2/27/51	6/30/52

The petitioner paid the Federal income and declared value excess profits tax reflected on its return for the year ending December 31, 1944, in the amount of $26,480.44, as follows:

March 15, 1945	$ 6,620.11
June 13, 1945	6,620.11
September 14, 1945	6,620.11
December 10, 1945	6,620.11
Total	$26,480.44

The petitioner paid the Federal income tax reflected on its return for the year ended December 31, 1945, in the amount of $8,322.17 on March 15, 1946.

14. The aggregate amount of loans secured by Deeds of Trust on houses sold at date of sale of all houses sold on the installment basis during each of the years 1942 and 1943, amounted respectively to $462,000.00 and $2,552,300.00. The loans in question are designated as "Mortgages on property sold" on the schedule on Page 18 of this stipulation. During each of the years 1942 and 1943, the

amount of the mortgage on each house sold on the installment plan was in excess of the cost of such house.

15. The "other collections on the contract price" as set forth in the schedule on Page 18, showing the Commissioner's computation of profit realized on installment sales do not include all collections on installment contracts. The "other collections on contract price" set forth in such schedule include only the principal portion of the level of payments collected during the period the first 27 installment payments are received over the level of payments prevailing during the remaining term of the contract as set forth on Page 11 above. No other part of payments which petitioner collected from the purchaser, either during the first 27 months or in any subsequent month, were included by the Commissioner in "other collections on contract price".

16. Whenever a purchaser under any installment contract paid petitioner the full sum designated in the contract as the purchase price, such purchaser was entitled to receive a deed to the property free and clear of the Deed of Trust.

Dated November 1, 1954.

/s/ DANIEL A. TAYLOR,
Attorney for Commissioner of
Internal Revenue.

Dated November 1, 1954.

/s/ BERT F. RABINOWITZ,
Counsel for Petitioner.

Dated November 1, 1954.

/s/ SCOTT H. DUNHAM,
Certified Public Accountant
of Counsel.

[Endorsed]: T.C.U.S. Filed November 4, 1954.

[Title of Tax Court and Cause No. 42446.]

AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiencies set forth by the Commissioner of Internal Revenue in his notice of deficiency issued by the Office of the Internal Revenue Agent in Charge, San Francisco Division (Symbols: IRA:90-D:CRA (C:AS:PD:SF:HGP)), dated April 9, 1952, and as a basis of its proceedings alleges as follows:

1. The petitioner is a corporation with its principal office at 3150 Twentieth Avenue (formerly 3455 Nineteenth Avenue), San Francisco, California. The returns for the periods here involved were filed with the Collector for the First District of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on April 9, 1952.

3. The deficiencies as determined by the Commissioner are deficiencies in income tax, declared value excess profits tax, and excess profits tax, as follows:

Taxable Year Ended December 31	Total	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1942	$ 46,549.58	$ 2,116.32	$ 6,514.86	$ 37,918.40
1943	393,146.81	21,803.05	61,998.28	309,345.48
1944	24,245.53	1,679.71	3,287.51	19,278.31
1945	18,748.35	17,686.81	1,061.54	
Total	$482,690.27	$43,285.89	$72,862.19	$366,542.19

The amounts of such taxes in controversy are deficiencies in income tax, declared value excess profits tax and excess profits tax, as follows:

Taxable Year Ended December 31	Total	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1942	$ 46,549.58	$ 2,116.32	$ 6,514.86	$ 37,918.40
1943	393,146.81	21,803.05	61,998.28	309,345.48
1944	24,245.53	1,679.71	3,287.51	19,278.31
1945	18,748.35	17,686.81	1,061.54	
Total	$482,690.27	$43,285.89	$72,862.19	$366,542.19

In addition the petitioner claims an overassessment of income tax and declared value excess profits tax for the year ended December 31, 1944, in the respective amounts of $25,507.49 and $972.95 and an overassessment of income tax for the year ended December 31, 1945 in the amount of $8,322.17.

4. The determination of the taxes set forth in said notice of deficiency is based on the following errors:

a. The Commissioner erred in determining that a portion only instead of all the installment payments actually received by this petitioner during the years 1942, 1943, 1944 and 1945 should be considered in determining the profits which this peti-

tioner realized during such years from the installment sales of single family residences during the years 1942 and 1943.

b. The Commissioner erred in determining that, for the purpose of the "contract price" under Section 44 of the Internal Revenue Code, the sales prices of the single family residences sold by this petitioner during the years 1942 and 1943 should be reduced by the outstanding mortgages thereon to the extent such mortgages did not exceed the basis of such residences to this petitioner.

c. The Commissioner erred in determining that 100% of that portion of the installment payments actually received by this petitioner during the years 1942, 1943, 1944, and 1945 from its sales during 1942 and 1943, which he considered as collections (i.e., total installment payments actually received) on such sales, constituted profit to it.

d. The Commissioner erred in determining that the gross profit to be realized when payments are completed should be returned as income over a period of less than three years, rather than over the entire period in which installment payments are actually received by this petitioner from the purchasers of the residences.

e. The Commissioner erred in determining that the excess of the mortgages outstanding against the homes sold over the basis of the homes to the petitioner constituted a part of the initial payments received by this petitioner.

f. The Commissioner erred in determining that this petitioner realized profit in the year 1942 on such installment sales in the amount of $76,358.58.

g. The Commissioner erred in not allowing this petitioner a net operating loss carryover from the year 1942 to the year 1944 in the amount of $22,-886.25.

h. The Commissioner erred in determining that this petitioner realized profit in the year 1943 on such installment sales in the amount of $579,982.50.

i. The Commissioner erred in not allowing this petitioner a net operating loss carryover from the year 1943 to the year 1945 in the amount of $54,-807.65.

j. The Commissioner erred in determining that salaries paid to officers of this petitioner during the year 1944 in the amount of $27,000.00 were not deductible in determining its net income for such year.

k. The Commissioner erred in determining that this petitioner realized profit in the year 1944 on such installment sales in the amount of $120,435.11.

l. The Commissioner erred in determining that salaries paid to officers of this petitioner during the year 1945 in the amount of $27,000.00 were not deductible in determining its net income for such year.

m. The Commissioner erred in determining that this petitioner realized profit in the year 1945 on such installment sales in the amount of $80,725.64.

n. The Commissioner erred in determining the average daily borrowed capital of this petitioner for the taxable year ended December 31, 1942, the first year of this petitioner's existence, without taking into account that such taxable year encompassed only 310 days.

o. The Commissioner erred in not allowing additional deductions for California bank and corporation franchise taxes during the years 1942, 1943, 1944, and 1945, which additional taxes would necessarily arise if the determination of the Commissioner relating to adjustments to this petitioner's income for such period were correct.

p. If the Commissioner's method of reporting the profits realized by this petitioner during the years 1942, 1943, 1944, and 1945 from the sales of the single family residences during the years 1942 and 1943 is correct, he has erred in the determination of the deficiencies in income and profits taxes for such years by reason of the fact that he has not taken into account net operating loss carrybacks from the years 1946 and 1947 and unused excess profits credit carrybacks from the years 1944 and 1945 all of which would arise primarily by reason of the reporting of this petitioner's profit for the years 1946 and 1947 from the sales in question in accordance with the method determined by the Commissioner.

q. The Commissioner erred by failing to determine that petitioner reported a profit of $75,833.18 for the year 1944 and no profit for the year 1945

as realized on certain installment sales made during the years 1942 and 1943, and that no portion of such amount of $75,833.18 with respect to these certain installment sales should have been reported as realized profit in the year 1944 and that only $5,685.02 of such amount of $75,833.18 with respect to these certain installment sales should have been reported as realized profit in the year 1945.

r. The Commissioner erred in not allowing a net operating loss deduction for the year 1944 in the amount of $22,886.25.

s. The Commissioner erred in not allowing a net operating loss deduction for the year 1945 in the amount of $54,807.65.

t. The Commissioner erred by failing to determine that the fair market value of each sales contract which this petitioner received upon the sale of each house sold during the year 1942 did not exceed 66⅔% of the face amount thereof at the date of sale and at all times during the year 1942.

u. The Commissioner erred by failing to determine that the fair market value of each sales contract which the petitioner received upon the sale of each house sold during the year 1943 (other than contracts with respect to sales of houses during 1943 which were collected in full during that year) did not exceed 66⅔% of the face amount thereof at the date of sale and at all times during the year 1943.

v. The Commissioner erred in determining the

petitioner's profit or loss on the sale during 1942 of 15 houses having an aggregate stated contract price in the amount of $65,800.00 and an aggregate cost in the amount of $51,094.50 on the installment basis under Section 44 of the Internal Revenue Code, although the petitioner did not elect in its return for the year 1942 to report such sales on the installment basis.

w. The Commissioner erred by failing to determine that the profit or loss realized by the petitioner on sale of each of the 15 houses described in subparagraph 4(v) above should be reported on the deferred payment method by treating the fair market value of each sales contract plus the amount of each down payment received as the consideration and by computing the profit or loss on each sale by comparing such aggregate consideration with the cost of each property sold.

x. The Commissioner erred in determining the petitioner's profit or loss on the sale during 1943 of 34 houses having an aggregate stated contract price in the amount of $152,800.00 and an aggregate cost in the amount of $113,184.28 on the installment basis under Section 44 of the Internal Revenue Code, although the petitioner did not elect in its return for the year 1943 to report such sales on the installment basis.

y. The Commissioner erred by failing to determine that the profit or loss realized by the petitioner on sale of each of the 34 houses described in subparagraph 4(x) above should be reported on

the deferred payment method by treating the fair market value of each sales contract plus the amount of each down payment received as the consideration and by computing the profit or loss on each sale by comparing such aggregate consideration with the cost of each property sold.

5. The facts upon which this petitioner relies as the basis of this proceeding are as follows:

a. This petitioner was incorporated under the laws of the State of California on February 25, 1942.

b. This petitioner constructed and sold 762 houses under the installment contract method during the years 1942 and 1943.

c. Sales of such houses during the years 1942 and 1943 amounted to $516,000.00 and $2,889,350.00, respectively. The costs of such houses to this petitioner were in the respective amounts of $401,-943.40 and $2,143,840.66, and the gross profits to be realized from such sales, when payments therefor were completed, were in the respective amounts of $114,656.60 and $745,509.34.

d. Initial payments received in connection with all sales reported by the petitioner on the installment basis under Section 44 of the Internal Revenue Code were in each case less than 30% of the sales price thereof.

e. This petitioner was entitled to elect to report the profits from such sales on the installment basis under Section 44 of the Internal Revenue Code.

f. The sales contract in the case of each sale set forth the full sales price of the residence. The difference between the sales price and the cash down payment constituted the amount of the unpaid balance due the petitioner from the buyer. Such balance was to be paid to the petitioner in monthly installments over a period of 25 years, together with interest thereon and payments to meet taxes and insurance on the property.

g. Each contract recited that a loan was outstanding against the residence at the time of sale, which loan the petitioner, as seller, agreed to pay.

h. Such loans had been previously made by the San Francisco Bank, San Francisco, California, to the petitioner and were Federal Housing Administration construction loans.

i. The petitioner was directly and primarily liable for the payment of such loans and has remained directly and primarily liable thereon for the unpaid balance thereof up to and including the present time.

j. In addition, the petitioner's stockholders, Ellis L. Stoneson, Henry Stoneson and Albert Bernhardt and their respective wives, Bertha K. Stoneson, Willette Stoneson, and Alfild Bernhardt, were and have continued to be personally liable for the unpaid balance on such loans.

k. The petitioner alone was required to make all payments on such loans and, in fact, it alone has made all such payments to the bank direct with

its own funds, whether or not it received payments from its purchasers on their obligations to it until installment contracts were closed and the properties deeded to the purchasers.

l. None of the purchasers of the residences has, in fact, ever assumed or paid to the bank any of such outstanding loans prior to the date contracts were closed and properties deeded to the purchasers.

m. All payments by the purchasers are required by the agreement of sale and have been made directly to and actually received by the petitioner.

n. Under the contract under which each residence was sold, the purchaser was entitled to a deed free and clear of the bank loan when he had paid the full sales price set forth in the contract.

o. The purchaser did not take the residence subject to the outstanding loan thereon.

p. Under Section 44 of the Internal Revenue Code, the formula for determining the percentage of profit realized by a seller on each installment payment received is as follows:

$$\frac{\text{Profit to be realized}}{\text{Contract price}} = \begin{array}{l}\text{Per cent of each installment} \\ \text{payment received which} \\ \text{constitutes profit.}\end{array}$$

q. Since each residence was neither sold subject to the outstanding loan nor was such loan assumed by the purchaser, Regulations 111, Section 29.44-2 (and the section of the preceding regulations) is not applicable in determining the profit realized by this petitioner upon such sales insofar as it pro-

vides that the amount of the mortgage to the extent it does not exceed the basis of the property to the seller is not a part of the "contract price" and to the extent that it implies that the amount of the loan in excess of the basis to the seller is a part of the "initial payment" received by the seller.

r. In the case here at issue, even if the purchaser took the property subject to the loan, such provisions of Regulations 111, Section 29.44-2 are not applicable to the particular facts here involved since their application in this case would operate to create a rule out of harmony with and in contravention of the provisions of Section 44 of the Internal Revenue Code and of the court decisions interpreting such provisions.

s. If the Commissioner is correct in determining that the above provisions of Regulations 111, Section 29.44-2 apply to the facts of the instant case, to that extent such Regulations operate to create a rule out of harmony with the Internal Revenue Code, which is neither reasonable nor consistent therewith.

t. As applied to the principal case, the "contract price" for the purpose of determining the amount of profit realized by the petitioner from each installment payment received by the purchaser of a residence is the selling price thereof set forth in the agreement of sale.

u. The total amount of each payment received by the petitioner from each purchaser which is ap-

plicable to the principal amount of the unpaid balance of the selling price constitutes the installment payment actually received for the purposes of determining the amount of the profit realized by the petitioner.

v. Under Section 44 of the Internal Revenue Code, this petitioner is entitled and required to return the gross profit to be realized as income over the entire period in which installment payments are actually received by this petitioner from the purchasers of residences.

w. During the years 1942 and 1943, the petitioner properly reported its profits from sales of residences made during such years with respect to which it had elected to report on the installment basis under Section 44 of the Internal Revenue Code.

x. The profit realized by the petitioner during the taxable year ended December 31, 1942, from sales which the petitioner had elected to report on the installment basis under Section 44 of the Internal Revenue Code was in the amount of \$3,193.07 and such profit for the calendar year 1943 was in the amount of \$50,616.16. Such profit for the calendar year 1944 was in the amount of \$51,833.78; and such profit for the calendar year 1945 was in the amount of \$75,918.03.

y. This petitioner was entitled to a net operating loss carryover from the year 1942 to the year 1944 in the amount of \$22,886.25.

z. This petitioner was entitled to a net operating loss carryover from the year 1943 to the year 1945 in the amount of $54,807.65.

aa. During each of the years 1944 and 1945, this petitioner paid properly salaries to its officers in the amount of $36,000.00, or $12,000.00 each to Ellis L. Stoneson, Henry Stoneson, and Albert Bernhardt.

bb. In view of the fact that such officers were entirely responsible for the operations and success of this petitioner and the further fact that they personally guaranteed the loan made to this petitioner, such salaries were reasonable in all respects and are deductible in computing the net income of this taxpayer in both the calendar year 1944 and the calendar year 1945.

cc. The aggregate daily borrowed capital of this petitioner for the taxable year ended December 31, 1942, in the amount of $40,096,510.01 should be divided by 310 days, the number of days in such taxable year, rather than 365 days, in determining the average daily borrowed capital of this petitioner for the taxable year ended December 31, 1942.

dd. The average daily borrowed capital of this petitioner for the taxable year ended December 31, 1942, was in the amount of $129,343.58.

ee. In the event any of the adjustments to this petitioner's income for the years 1942, 1943, 1944, and 1945 determined by the Commissioner are sustained, such adjustments would result in additional California bank and corporation franchise taxes.

ff. Such additional California bank and corporation franchise taxes accrue as of the first day of the taxable year for which they are imposed.

gg. This petitioner, being on the accrual method of reporting income and expenses except as to the installment sales of residences, is entitled to deduct any additional California bank and corporation franchise taxes in the year in which such taxes accrue.

hh. If the Commissioner is correct as to the method of reporting this petitioner's profits from the sales in question, this petitioner suffered net operating losses in the years 1946 and 1947 in the respective amounts of $33,982.45 and $39,680.96.

ii. Such net operating losses constitute net operating loss deductions for the years 1944 and 1945 in the same amount, no adjustments under Section 122 being required.

jj. Such net operating loss deductions give rise to unused excess profits credit carrybacks from the years 1944 and 1945 in the respective amounts of $6,141.19 and $35,358.67, which carrybacks should be applied against this petitioner's excess profits tax net income for the years 1942 and 1943, respectively.

kk. This petitioner elected to report the following sales of real property on the installment basis under Section 44 of the Internal Revenue Code:

Year	Number of Sales	Sales Price	Cost	Profit to be Realized
1942.........	103	$ 450,800.00	$ 350,848.90	$ 99,951.10
1943.........	605	2,714,500.00	2,014,011.65	700,488.35
Total....	708	$3,165,300.00	$2,364,860.55	$800,439.45

ll. Due to an error in preparing its return for the year 1944 this petitioner reported therein the entire balance of the unrealized profit on installment sales of 105 houses which it had sold during the years 1942 and 1943. The actual balance of the unrealized profit on the sale of such 105 houses at December 31, 1944, amounted to $75,833.18; and as the result of such error, profits reported during the year 1944 were overstated in the amount of $75,833.18, and profits reported during the year 1945 were understated in the amount of $5,685.02.

mm. The fair market value of each sales contract which the petitioner received upon the sale of each house sold during the years 1942 and 1943 (other than contracts with respect to houses sold in 1943 which were collected in full in that year) did not exceed 66⅔% of the face amount thereof at the date of sale and at all times during the year of sale.

nn. This petitioner did not elect to report the following sales of real property on the installment basis under Section 44 of the Internal Revenue Code:

Year	Number of Sales	Stated Contract Price	Cost	Profit to Be Realized in the Event Stated Contract Price Is Collected in Full
1942	15	$ 65,800.00	$ 51,094.50	$14,705.50
1943	34	152,800.00	113,184.28	39,615.72
Total	49	$218,600.00	$164,278.78	$54,321.22

oo. The profit or loss realized by the petitioner on the sale of each of the 49 houses described in the subparagraph 5(nn) above should be reported on the deferred payment method by treating the fair market value of each sales contract plus the amount of each down payment received as the consideration and by computing the profit or loss on each sale by comparing such aggregate consideration with the cost of each property sold.

pp. The loss sustained by the petitioner in the year 1942 on the sale of the 15 houses sold in such year described in subparagraph 5(nn) above was in the amount of $6,594.51.

qq. The loss sustained by the petitioner in the year 1943 on the sale of the 34 houses sold in such year described in subparagraph 5(nn) above was in the amount of $9,617.60.

rr. By reason of the fact that the fair market value of each sales contract which the petitioner received upon the sale of the houses listed in subparagraph 5(nn) above did not exceed 66⅔% of the face amount thereof at the date of said sale and at all times during the year of sale, the following income was realized by the petitioner during the years 1942, 1943, 1944, and 1945, with respect to collections on such contracts during such years:

Year of Collection	1942 Sales	1943 Sales	Total
1942	$ 18.75		$ 18.75
1943	2,381.11	$ 1,455.97	3,837.08
1944	2,357.61	6,685.55	9,043.16
1945	685.46	7,341.70	8,027.16
Total	$5,442.93	$15,483.22	$20,926.15

ss. The petitioner was not entitled to and did not elect to report the following sales of real property made during the year 1943 on the installment basis under Section 44 of the Internal Revenue Code inasmuch as the entire stated contract price of each such sale was collected during the year of sale:

Year	Number of Sales	Stated Contract Price	Cost	Profit
1943	5	$22,050.00	$16,644.73	$5,405.27

tt. This petitioner was entitled to a net operating loss deduction for the year 1944 from the year 1942 in the amount of $22,886.25.

uu. This petitioner was entitled to a net operating loss deduction for the year 1945 from the year 1943 in the amount of $54,807.65.

Wherefore, the petitioner prays that this Court may hear the proceeding and:

(1) Determine that there are no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the taxable year ended December 31, 1942; no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the year ended December 31, 1943; no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the year ended December 31, 1944; no deficiencies in income tax, declared value excess profits tax, and excess profits tax for the year ended December 31, 1945; that the petitioner has made overpayments of income tax

and declared value excess profits tax for the year ended December 31, 1944 in the respective amounts of $25,507.49 and $972.95; that such overpayments for the year 1944 were each made within three years prior to the execution of an agreement by both the Commissioner and the petitioner pursuant to Section 276(b) of the Internal Revenue Code of 1939, as amended, to extend beyond the time prescribed in Section 275 thereof the time within which the Commissioner might assess the tax for the year 1944; that such agreement by the Commissioner and the petitioner for the year 1944 pursuant to Section 276(b) of the Internal Revenue Code of 1939, as amended, was executed within three years from the date of filing of the petitioner's income and declared value excess profits tax return for the calendar year 1944; that such overpayments for the year 1944 should be refunded to the petitioner under Section 322(d) of the Internal Revenue Code of 1939, as amended, and Section 6512(b) of the Internal Revenue Code of 1954, together with interest thereon; that the petitioner has made an overpayment of income tax for the year ended December 31, 1945, in the amount of $8,322.17; that such overpayment for the year 1945 was made within three years prior to the execution of an agreement by both the Commissioner and the petitioner pursuant to Section 276(b) of the Internal Revenue Code of 1939, as amended, to extend beyond the time prescribed in Section 275 thereof the time within which the Commissioner might assess the tax for the year 1945; that

such agreement by the Commissioner and the petitioner for the year 1945 pursuant to Section 276(b) of the Internal Revenue Code of 1939, as amended, was executed within three years from the date of filing of the petitioner's income tax return for the calendar year 1945; and that such overpayment for the year 1945 should be refunded to this petitioner under Section 322(d) of the Internal Revenue Code of 1939, as amended, and Section 6512(b) of the Internal Revenue Code of 1954, together with interest thereon;

(2) Determine that the average daily borrowed capital of this petitioner for the taxable year ended December 31, 1942, was in the amount of $129,-343.58;

(3) Determine that this petitioner is entitled to deduct any additional California bank and corporation franchise taxes arising from adjustments in this taxpayer's income determined by the Commissioner in the years in which such taxes accrue;

(4) Determine that in the event the Commissioner is correct in his determination of the method by which the installment profits from the sales here in question should be reported, this petitioner is entitled to net operating loss deductions for the years 1944 and 1945 in the respective amounts of $33,982.45 and $39,680.96, and unused excess profits credit carrybacks applicable to the years 1942 and 1943 in the respective amounts of $6,141.19 and $35,358.67; and

(5) Grant such other relief, as in the opinion of the Court this case may warrant.

Respectfully submitted,

/s/ BERT F. RABINOWITZ,
Counsel for Petitioner.

/s/ SCOTT H. DUNHAM,
Certified Public Accountant
of Counsel.

Duly Verified.

[Endorsed]: T.C.U.S. Filed November 4, 1954.

[Title of Tax Court and Cause No. 42446.]

ANSWER TO AMENDED PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, and for answer to the amended petition filed by the above-named petitioner admits and denies as follows:

1, 2, 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the amended petition.

4 and 4-a to y, inclusive. Denies that the Commissioner erred in the determination of the deficiencies as alleged in paragraph 4 of the amended petition and subparagraphs a to y, inclusive, thereunder.

5-a to h, inclusive. Admits the allegations contained in subparagraphs a to h, inclusive, of paragraph 5 of the amended petition.

i. Denies the allegations contained in subpara-

graph i of paragraph 5 of the amended petition.

j and k. Admits the allegations contained in subparagraphs j and k of paragraph 5 of the amended petition.

l. Denies the allegations contained in subparagraph l of paragraph 5 of the amended petition.

m and n. Admits the allegations contained in subparagraphs m and n of paragraph 5 of the amended petition.

5-o. Denies the allegations contained in subparagraph o of paragraph 5 of the amended petition.

p. Admits the allegations contained in subparagraph p of paragraph 5 of the amended petition.

q to dd, inclusive. Denies the allegations contained in subparagraphs q to dd, inclusive, of paragraph 5 of the amended petition.

ee. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraph ee of paragraph 5 of the amended petition.

ff and gg. Denies the allegations contained in subparagraphs ff and gg of paragraph 5 of the amended petition.

hh to jj, inclusive. For lack of knowledge or information sufficient to form a belief, denies the allegations contained in subparagraphs hh to jj, inclusive, of the amended petition.

kk to uu, inclusive. Denies the allegations contained in subparagraphs kk to uu, inclusive, of paragraph 5 of the amended petition.

6. Denies generally and specifically each and

every allegation in the amended petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ DANIEL A. TAYLOR,
Chief Counsel, Internal Revenue Service.

Of Counsel: Melvin L. Sears, Regional Counsel; T. M. Mather, Asst. Regional Counsel, Internal Revenue Service.

[Endorsed]: T.C.U.S. Filed November 15, 1954.

In the Tax Court of the United States

Docket Nos. 42445-42446

THE STONECREST CORPORATION, THE BROOKFIELD CORPORATION,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

TRANSCRIPT OF PROCEEDINGS

Courtroom 421, Appraisers Building, 630 Sansome Street, San Francisco, California, Thursday, November 4, 1954.

The above-entitled matter came on for hearing,

pursuant to notice to the parties, at 10:00 o'clock, a.m.

Before: Honorable Norman O. Tietjens, Judge, Presiding.

Appearances: Bert F. Rabinowitz, Esq., 602 Market Street, San Francisco, California, for the Petitioners. Scott H. Dunham, Esq., 510 Crocker Building, San Francisco, California, for the Petitioners. T. M. Mather, Esq., 870 Market Street, San Francisco, California, for the Respondent. [1]*

* * * * *

Mr. Mather: It may be stipulated that the compensation deduction in the Stonecrest case for officers' salary is allowable in the amount of $14,400 for the years 1944 and '45. That is $7,200 for each of the two officers for each of the two years, and in the Brookfield Corporation an allowance for each officer's salary of $36,000 for the year 1944. That is $12,000 apiece for each of three officers for the year 1944, and that will dispose of the salary issue. May that be stipulated?

Mr. Rabinowitz: Yes. * * * * * [5]

Mr. Rabinowitz: As I have stated, before the Court at this time are the Petitions of two corporations, the Stonecrest Corporation, and the Brookfield Corporation.

Each of these corporations was formed shortly after Pearl Harbor, one in the early part of January, '42, one in the latter part of February, '42. Both were formed for the same function. There

* Page numbers appearing at top of page of original Reporter's Transcript of Record.

was in existence at that time a partnership known as Stoneson Brothers, of whom the partners were two brothers, Henry and Ellis Stoneson. They had been engaged in this area and elsewhere in the subdivision business for many years and were well known and had a reputation as competent builders.

Shortly before the outbreak of the war, and increasingly immediately afterwards, there was a great and an acute shortage [6] of low cost housing for war workers in the defense efforts. Representatives of the Government, particularly the War Production Board, came to these builders and urged upon them the necessity and desirability of their entering into the immediate construction in large numbers of low cost housing.

There were difficulties attendant to that type of operation not inherent in ordinary subdivision activities. First of all, the war was on; the duration and result were then unknown. There had been bombing along the coast here and there was—and this was a desirable point of attack for the enemy.

The purchasers would be people who had nothing but their jobs, and in most cases, or in many cases they were migratory workers who had been brought here from the Midwest to defense plants.

They would be called upon under the plan envisioned to make a nominal down payment, usually 100 or 150 dollars, and they would be given the opportunity of paying for the houses in small instalments over a long period of time, which was generally twenty-five years, and in some cases, in the first year, twenty years.

Those payments spread over that period were small, and the uncertainty as to whether or not they would remain to pay their purchase price or whether they would disperse and scatter at the end of the war was an intangible, a variable, [7] which could not be computed on any scientific basis.

In addition, as a part of the program, to induce these and other builders to engage in this activity, the Federal Housing Administration had made money available through Title 6 loans by which the builder would borrow from a bank. In this particular case, and in every case, it was the San Francisco Bank here. They would borrow money on notes signed by the Petitioner, secured by a deed of trust on the property, and in each such case the loan was approximately 90 per cent of the selling price.

The bank was protected in that its loan was insured by the Federal Housing Administration, but the builder, the Petitioners in these cases, had to sign notes secured by deeds of trust, and were not protected.

The Federal Housing Administration or no one guaranteed that the purchasers would make their payments nor was there any provision to relieve the sellers from their primary and continuous liability on the notes in the event the purchasers did not make their payments.

That is a general statement of the origin of this, of these two Petitions. [8]

* * * * *

We believe that insofar as the regulations relat-

ing to Section 44 are concerned, which go further than the Code, and which state—and I don't wish to argue the law, but I merely wish to orient and focus our position—which state: "In the sale of mortgaged property the amount of mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as part of the selling price, but the amount of the mortgage to the extent it does not exceed the basis of the inventory of the property sold shall not be considered as a part of the initial payment or of the total price as those terms are used," et cetera.

We believe with respect to those regulations that in the first place they do not apply to the facts of this case. It is stipulated that no mortgage was assumed. it is our position that in no case did the purchaser agree to take the property subject to a mortgage.

It is our position that, and it is so stipulated, that in every case when the purchaser paid the purchase price in full, he was entitled to a deed free and clear of the encumbrance, [20] and that "subject to" means that when the purchaser has completed everything he is required to do under his contract and has deeded the property to the purchaser and the purchaser has paid the seller everything he is required to pay the seller, the purchaser cannot complain if there is at that time an encumbrance or mortgage subsisting against the property, because he has agreed to take the property subject to the mortgage, and in our case it is

our position that no purchaser has so agreed, and that if any purchaser who has paid the purchase price cannot be compelled to take a deed with any mortgage subsisting against the property.

It is our further position that if it be ruled that the regulations do apply to our situation and to the facts in this case, to that extent the regulations are in conflict with the Code because, one, it does not take into consideration all payments actually received during the year, it includes the substantial portion of the payments, and, in the second place, it does not include, as the Commissioner has implied, the moneys not received from the purchaser but from a third party. [21]

* * * * *

Mr. Mather: If your Honor please, those are substantially the facts in these cases.

Our principal dispute is in the contract price and the initial payment. We have computed the tax in strict accordance with the Commissioner's regulations in these cases, and those regulations have been held to be valid by the United States Supreme Court.

Now, the difference arises because the Petitioners treat as the selling price the contract price. In other words, he says the selling price and the contract price are the same. The Commissioner says that the selling price is what the property was sold for, but the contract price is the selling price less mortgages limited to the cost of the property sold, and in each instance the mortgage exceeded the cost of the property sold, and the difference

between the mortgage and the cost was included in the initial payment. [22]

So, we have contract price and initial payment, in which we disagree with the taxpayers in these cases, and that is primarily the—our dispute here. Of course, we have a dispute that this property was not sold subject to a mortgage.

Well, I think the Supreme Court of the United States has disposed of that in the Crane case.

The Court: Beulah Crane?

Mr. Mather: I think so.

If your Honor please, in every instance in these cases there was a mortgage on the property when the property was sold to the purchaser. Now, the mortgage still exists as long as that contract was in effect until the contract was closed; then the mortgage was satisfied.

Now, it is our position that these properties were taken subject to the mortgages.

The Court: Call your witness.

Mr. Rabinowitz: Mr. Stoneson, will you take the stand.

HENRY STONESON

was called as a witness in his own behalf, and, having been first duly affirmed, was examined and testified as follows:

The Clerk: Will you state your name, please?

The Witness: Henry Stoneson.

Direct Examination [23]

* * * * *

Q. (By Mr. Rabinowitz): You heard my statement as to the general war conditions and the cir-

(Testimony of Henry Stoneson.)

cumstances surrounding the corporations, these two corporations, and it was substantially correct?

A. It was, sir.

Mr. Rabinowitz: It will shorten the examination. Thank you, your Honor.

Q. (By Mr. Rabinowitz): With respect to the 12 to 13 hundred sales involved in both these cases, generally speaking, was there any problem of collection and delinquency in payment of the instalments?

A. Well, yes. At no time did the payments come in too promptly. It required prodding on our part by telephone, by letter, and the usual collection methods, and at all times we had substantial amounts in delinquent form.

Q. Now, Mr. Stoneson, with respect to Brookfield Corporation, do you hold any office with that company? A. Yes.

Q. What is it? A. I am the President.

Q. And you have been since its incorporation?

A. I have been since its incorporation.

Q. With respect to the fifteen sales in 1942 and the thirty-four sales in 1943, which Brookfield did not elect to report on the instalment basis, did Brookfield realize in each [24] of the years as profit the difference between the selling price and the cost of the homes sold?

A. No, they did not realize a profit.

Q. Why not?

A. Well, we had—these purchasers were in on a very low down payment, the contract extending

(Testimony of Henry Stoneson.)

over a long period of years, as much as twenty-five years, I believe, in this particular case, very low rate of interest.

These mortgages were not marketable, could not be realized, and in addition there was a loan against the property.

Q. When you say "mortgages," are you referring to the contracts, sir?

A. The contracts I was referring to.

Q. At the time the contract was entered into, what had you received from the purchaser?

A. A very nominal amount, running from 100 to 150 dollars, I would say, generally.

Q. Anything else? A. That is all.

Q. In your opinion, what was the value of the contract, the purchaser's agreement to pay the balance of the purchase price at that time?

A. Well, I couldn't give it in value.

Mr. Rabinowitz: That is all. [25]

One further question.

Q. (By Mr. Rabinowitz): Would your opinion as to the value of that contract — we have been speaking of the fifteen and thirty-four cases only—in which no election had been made to report on the instalment basis—would your opinion as to the value of the purchaser's contract be the same with respect to the contract on which you had elected to report on the instalment basis?

A. I believe the contract would be the same value, yes.

Q. And that value was what?

(Testimony of Henry Stoneson.)

A. No value.

Mr. Rabinowitz: That is all.

Cross Examination

Q. (By Mr. Mather): Mr. Stoneson, did any of these contracts default? A. Did they default?

Q. Yes.

A. Give up their houses, is that what you are talking about?

Q. Yes.

A. I believe there were some that defaulted.

Q. Well,——

A. Although we wouldn't know about them; that is, they would provide their own purchasers, their resales. [26]

Q. Well, they didn't default to you?

A. No.

Q. None of these contracts defaulted to you, did they? A. No.

Q. They were carried out in accordance with their terms?

A. Yes. It took considerable prodding to collect the payments.

Q. I am not asking you about that, I am asking did they carry their contracts out in accordance with their terms, or did they not?

A. They were delinquent; outside of that, they carried out their terms.

Q. Yes. You didn't have to take their property back? A. No.

(Testimony of Henry Stoneson.)

Q. And this was a rising market at all times after the sale, was it not?

A. Not at all times, no.

Q. Well, could you buy any of those properties today at the price at which they were sold?

A. Today, no. [27]

* * * * *

Q. (By Mr. Mather): Mr. Stoneson, at the end of twenty-seven months on these contracts the balance that remained due was the balance owing on the mortgage, was it not? A. No, it wasn't.

Q. Well, what was the balance that was due at the end of twenty-seven months?

A. The balance due on our contracts?

Q. Yes.

A. It was the balance due—owing us on that contract, whatever the figure might be. It had no relation to any loan that we had on the property.

Q. None whatever? A. None whatever.

Q. Well, let's take a typical sale; a typical sale for these properties was for $4500, was it not?

A. That's right.

Q. And your down payment, say, was $150.00?

A. Yes, sir. [28]

Q. And the mortgage on the property was $4,000; is that correct?

A. Let's see. I assume that would be right, yes.

Q. So the selling price was $500 in excess of the mortgage on the property at the time you sold it? A. Right.

Q. Now, that down payment of $150 and the

(Testimony of Henry Stoneson.)

remaining $350 in excess of the mortgage was amortized over a period of twenty-seven months, was it not? A. Not necessarily.

Q. Well, how was it paid?

Mr. Rabinowitz: Mr. Mather, may I, without trying to interrupt your questioning,—I assume you mean when twenty-seven payments were made, not the twenty-seven months.

Mr. Mather: Well, the payments were made monthly over twenty-seven months.

Mr. Rabinowitz: Well, if your Honor please, we will assume that they were made.

Mr. Mather: Well, I will ask him. He said the contracts weren't in default.

The Witness: I said they were in a delinquent state from time to time.

Mr. Mather: Yes.

Q. (By Mr. Mather): At the end of twenty-seven months, this would have [29] been paid if the contracts had been carried out in accordance with the terms, would it not?

A. I believe that is the way it figures out.

Q. Then the remaining balance on your contract of sale would only be what remained due on the mortgage, would it not?

A. No. Pardon me. No, the due dates, or the payment dates on the mortgages that we had made through the San Francisco Bank and the contractors' contracts between our purchasers and ourselves were not identical. They would vary. So there

(Testimony of Henry Stoneson.)
would be a variance in the amounts of the two that you are talking about.

Q. Well, what would the variance be?

A. Depending on the variance in the due dates of the two types of payments.

Q. Assuming that the payments were $40.00 a month, there would be a $40.00 difference?

A. Well, I couldn't answer that; that is a little too much arithmetic for me to answer.

Q. Well, at the expiration of the twenty-seven month period, the loan on the property had been diminished by payments that had been made by the purchaser, had they not?

A. When you say "loan," which loan are you referring to?

Q. Well, let's go back to the start. [30]
You entered into a contract in these properties with the sellers, did you not? A. Yes.

Q. And all you had was a contract?

A. Was a contract, that's right, sir.

Q. And the purchaser made payments in accordance with the terms of that contract, did he not? A. Right.

Q. And at the end of twenty-seven months he had made the payments that were required if the contract wasn't in default? A. Right.

Q. And those payments were applied to amortize the $500 that I spoke of, in addition to the mortgage, so that all that remained at the expiration of that period for payment was the balance remaining on the mortgage; is that true?

(Testimony of Henry Stoneson.)

A. The payments on the mortgage would vary from the payments on the contract; that is, the amount in the balance due, due to the fact we had different starting dates on the two different documents. We made our bank payments promptly the day that we were required to in accordance with the terms in that note and deed of trust, and in return we collected from our purchaser according to the terms of our contract.

Q. Let me show you this schedule, Mr. Stoneson. Now, a contract of sale on a typical property was $4,500, was it not? [31] A. Yes.

Q. And the down payment was $150?

A. That's right.

Q. And the first mortgage loan was $4,000?

A. Correct.

Q. The balance of the first payment—or, the balance of the first period was $350?

A. That was the—that is what it says there, correct.

Q. Well, is that correct?

A. That is correct. That is the way the contract was set up.

Q. Yes. So under these contracts there was a monthly payment of $45.00, and $50.00, during the first period, was there not? A. Yes, sir.

Q. So at the end of twenty-seven months this $350 balance had been paid off and the mortgage had been reduced to $3,992.76, had it not?

Mr. Rabinowitz: Pardon me. I am not following

(Testimony of Henry Stoneson.)

you. Are you implying that the purchaser was paying the mortgage to the bank, sir?

Mr. Mather: I am just asking him what happened on these contracts.

Mr. Rabinowitz: Well, I think your question is confusing. [32]

Mr. Mather: Well, maybe Mr. Stoneson doesn't understand it, I don't know.

A. Well, I do understand it, Mr. Mather, yes. We made the payments on our bank loan. Let's call it a bank loan so we can distinguish it from our contract.

Q. (By Mr. Mather): Yes.

A. We made that separate from our contract collections.

Q. Yes.

A. On the due dates we paid them.

Q. So the balance due on your mortgage to the bank at the expiration of twenty-seven months was $3,992.76?

A. Well, you have a case there where I couldn't —I don't know about this. I don't know where it came from.

Q. Well, isn't that in substance what happened in all of these contracts?

A. Well, not that—our contract purchaser was not paying on our bank loan.

Q. I am not asking that. I am assuming and the contract provided for monthly payments for the first twenty-seven months of $45.50.

A. Correct.

(Testimony of Henry Stoneson.)

The Court: That is, from the purchaser of the house to the seller of the house?

Mr. Mather: That is correct. [33]

Q. (By Mr. Mather): Is it not?

A. That is correct.

Q. And you assumed that those payments had been made to you in accordance with the terms of that contract for the period of twenty-seven months? A. Yes.

Q. Your books would show that this $350 had been paid and that there remained due and owing on the $4,000 mortgage, $3,992.76, would it not?

A. I believe that would be correct.

Q. Yes. Now, at that time, that mortgage was insured by an F.H.A. loan, was it not, to the bank?

A. It was insured to the bank only.

Q. Yes, so the bank was actually protected only on that loan by an F.H.A. loan for that balance?

The Court: You mean by F.H.A. insurance?

Mr. Mather: That is correct.

A. They had an F.H.A. insurance policy on the loan.

Q. (By Mr. Mather): Well, that loan was guaranteed by F.H.A., was it not, during that period, at that time? A. I believe that is correct.

Q. Yes. And at the time these contracts were entered into, Mr. Stoneson, the purchaser furnished —did he furnish [34] you with a financial statement?

A. I don't recall the details of that, Mr. Mather.

(Testimony of Henry Stoneson.)

Q. Did he furnish the F.H.A. with a financial statement? A. I don't recall.

Q. You don't know?

A. Just what was said.

Q. In your opinion, would these contracts that were executed by the purchaser have any value irrespective of who the purchaser might be?

A. I don't think they would have any value.

Q. Assume that the San Francisco Bank was the purchaser, the contract would have no value?

A. We were in an all-out war at the time these houses were built, and I don't think that anybody could predict what would happen in the next twenty-four hours.

Q. Is it your testimony that irrespective of the financial responsibility of the purchaser, the contract had no value? A. Correct.

Q. That is correct? A. Correct.

Mr. Mather: That is all.

Redirect Examination

Q. (By Mr. Rabinowitz): Mr. Stoneson, to clear up one point only, if—and [35] it is stipulated in the facts—the seller had to pay the bank on the loan, usually on the first day of the fourth month or first day of the sixth month after the loan was made, and if, as is stipulated in the facts, the purchaser had to pay the instalments to you, usually the month after his contract was signed or the month after the home was completed, is it not a fact that unless the date of the first payment by

(Testimony of Henry Stoneson.)
the seller on its loan to the bank and the date of the first payment by the purchaser on his instalment to the company coincided, and if it is not the further fact that each of the next twenty-seven payments was made by each punctually as required, is it not a fact that there would never be a correspondence between the amount due the seller from the buyer and the amount due from the seller to the bank? A. That is correct. [36]

* * * * *

HARRY SMISSAERT

was called as a witness by and on behalf of the Petitioners, and, having been first duly affirmed, was examined and testified as follows:

The Clerk: Will you state your name, please?

The Witness: Harry Smissaert.

Direct Examination

Q. (By Mr. Rabinowitz): Mr. Smissaert, what is your occupation? A. Real estate broker.

Q. And where is your headquarters?

A. Where is my office?

Q. Yes. A. 64 Sutter Street.

Q. How long have you been engaged in business in this community and area?

A. About forty to forty-five years.

Q. Are you connected with any firm?

A. Yes, Thomson, Kernan & Stevens. [37]

Q. That is a corporation?

A. A corporation.

Q. And you are its President?

(Testimony of Harry Smissaert.)

A. Its President.

Q. How long has that firm been in business in this area? A. Since 1886.

Q. What type of activity does the firm engage in?

A. General real estate, property management, sales, loans, and anything in conjunction with real estate business.

Q. In what capacities have you acted, specifically? Do you act as a principal for your own account or do you act as a broker?

A. Well, in the office I act as a broker. I buy and sell property occasionally outside.

Q. Have you dealt in mortgages? A. Yes.

Q. And have you dealt in loans? A. Yes.

Q. Have you dealt in contracts of sale?

A. Yes.

Q. Are you familiar in that field insofar as banks, insurance companies and financing institutes are concerned? A. Yes.

Q. Now, Mr. Smissaert, assuming that a company sold [38] single-dwelling houses for $4450 or $4500 under contracts of sale calling for a small down payment of a hundred or a hundred and fifty dollars, the balance to be paid in monthly instalments over a period of twenty-five years, or in some cases over a period of twenty years: assume that there is a uniform level of instalments for the first twenty-seven months, and assume that there is a uniform level of instalments for the remaining life of the respective contracts at a lower level; assume

(Testimony of Harry Smissaert.)

that for the first level of payment the contract bears interest at the rate of 6 percent in some cases and in some cases bears interest at the rate of 6 percent on so much of the first instalments which are at a higher rate than the second set of instalments, and 4½ percent on the remainder, and assuming that in all cases after the twenty-seven payments have been made the rate of interest is uniformly 4½% percent, and assuming that in every case at the time the contract of sale is entered into there is subsisting against the property a deed of trust to the San Francisco Bank, securing a loan in the approximate amount of 90 percent of the sales price; assume further that the purchaser was a worker in an essential war industry; what, in your opinion, was the fair market value of that contract in the year 1942?

A. Well, I would feel that the contract would be very, very difficult to dispose of because of the fact that the interest is lower than the loan people would ask for, and I [39] wouldn't know how to put a value on that.

Q. In your opinion, was there a market value for such paper in 1942? I am confining myself now to the year '42. A. I wouldn't think so.

Q. In your opinion, what is the fair market value for a similar contract under identical factual situation in each of the years 1942, 1943, 1944, and 1945?

A. Well, in my opinion, the same condition would prevail in all of those years.

Q. And, in your opinion, would your opinion be

(Testimony of Harry Smissaert.)
affected whether or not the house was technically in San Francisco, as in the case of Stonecrest, or in Alameda County, as in the case of Brookfield?

A. Well, very much the same conditions would prevail, I believe.

Mr. Rabinowitz: That is all.

Cross Examination [40]

* * * * *

A. Well, at that time, war workers were very uncertain as to how long they would be able to continue to make their payments, and no one knew anything about it.

Q. (By Mr. Mather): Well, I assume there were differences in war workers. Some war workers might have some financial responsibility, whereas others——

A. Well, I am only referring to what you would call the general trend.

Q. Yes.

A. If I am correctly informed, the majority of these houses or all of them were sold to war workers. [41]

Mr. Rabinowitz: They were built for war workers.

The Court: I think that is one of the assumed facts in your question. [42]

* * * * *

Redirect Examination

Q. (By Mr. Rabinowitz): Mr. Smissaert, I did not include in my hypothetical question the fact

(Testimony of Harry Smissaert.)

that there is involved not a single contract for the purchase of what we are trying to arrive at at this time but a volume of contracts running into the millions, and would your answer be affected either way with that additional fact in the question?

A. Yes.

Q. How?

A. Well, the larger amount would be more difficult to dispose of, or practically impossible to dispose of, where an occasional contract might be disposed of at some figure.

Mr. Rabinowitz: That is all. [44]

* * * * *

Further Redirect Examination

Q. (By Mr. Rabinowitz): Mr. Smissaert, let's assume that you had a financially responsible name on the purchaser, would the fact that the contract ran over twenty-five years, involve for the most part a rate of interest of 4½ percent, and that there was subsisting against the property a mortgage to the extent of approximately 90 percent, have any effect on the value of that paper, even though signed by the Old Lady of Threadneedle Street?

A. Well, it would have, naturally, some effect. It couldn't help itself.

Q. What discount, if any, would be required because of the terms of the paper and the fact of the 90 percent mortgage on the property, regardless of who was the—what was the financial responsibility of the signer?

(Testimony of Harry Smissaert.)

A. I don't think I quite understand your question. I would like to have it made a little clearer.

Q. Let's assume that the signer of the note was financially responsible in the fullest sense that you can think of [46] that term. Would the fact that the contract ran for twenty-five years, that the rate of interest for the most part was 4½ percent, and that there was subsisting against the property a mortgage to the extent of 90 percent of the sales price, would that require any discount of the paper, or would it not? A. Yes.

Q. In your opinion, assuming the financial irreproachable reputation of the maker, what type of discount would be required because of these factual situations?

A. Well, it would be required to bring it up to a rate of interest that somebody, what you would call a tough buyer, would be willing to accept.

Q. In your opinion, what is the minimum discount that would have been required, assuming a financially responsible person, and assuming no war?

A. Well, I would say from 50 to 60 percent would be the minimum.

Mr. Rabinowitz: That is all. [47]

* * * * *

DAVID GREEN

was called as a witness by and on behalf of the Petitioners, and, having been first duly affirmed, was examined and testified as follows:

Mr. Mather: We can do that later.

The Clerk: What is your name?

The Witness: David Green.

Direct Examination

Q. (By Mr. Rabinowitz): Mr. Green, what is your business? [49]

A. I am an executive for a real estate loan corporation.

Q. What is the name of the company?

A. The EMCO Investment Company, E-M-C-O Investment Company.

Q. Where are its offices located?

A. 544 Market Street.

Q. Here in San Francisco?

A. San Francisco.

Q. How long has that company been in operation?

A. That company has been in existence since the early 20's.

Q. And did I understand you to say you were the Executive Officer of the company?

A. I am the General Manager, also Assistant Secretary of the Corporation.

Q. And what is the business, what are the operations of your company?

A. Our operations are making real estate loans and buying deeds of trust and contracts of sale.

(Testimony of David Green.)

Q. And, with becoming modesty, sir, what volume is your corporation engaged in this business?

A. Well, I would say offhand it runs from 2 to 3 million dollars.

Q. I see, and that has been the business of this [50] corporation for many years?

A. Yes, sir.

Q. You have dealt with first and second mortgages?

A. Both first and second mortgages.

Q. You have dealt with loans?

A. Yes, sir.

Q. You have dealt with lending organizations, insurance companies, banks, building and loan?

A. Yes.

Q. And you have dealt with paper of all sorts relating to real property? A. Yes, sir.

Q. You have been in court, but I will repeat the question.

Assuming that Stonecrest Corporation or the Brookfield Corporation under a contract of sale sold a single-dwelling house for approximately $4450, the contract of sale calling for a down payment of a hundred or a hundred and fifty dollars, and providing for the payment of the purchase price, in some cases over a period of twenty-five years, and in other cases over a period of twenty years; providing further for a uniform level of monthly instalments to be paid for the first twenty-seven instalments, and for a uniform but lower level of payments for the remaining life of the con-

(Testimony of David Green.)

tract, which would be the difference between the twenty-seven months [51] and the — the twenty years, or the twenty-seven months and the twenty-five years, as the case may be; assuming further that the payments during the first twenty-seven instalments bore interest at the rate of 6 per cent, or 6 per cent on just a part and 4½ per cent on the remaining part, and in all cases bore uniform interest of 4½ per cent for all payments after the twenty-seven payments; and assuming that in every case at the time that the contract of sale was entered into there subsisted against the property covered by the contract a first deed of trust to the San Francisco Bank, securing a loan in approximately 90 per cent of the entire selling price, what in your opinion was the fair market value of that contract in the year 1943, and I will add the further assumption that in each case the purchaser was required by law and was employed in an essential industry.

A. Well, judging strictly from my own experience and from our modus operandi, that as far as our concern is concerned there would be no value to that contract of sale.

Q. Was there, in your opinion—now, eliminating just your own concern — was there a fair market value so far as you know for such a contract in the year 1952? A. My answer would be no.

Q. Would your answer be any different in the years '42, '43, '44 and '45, given the same facts?

A. No. The general business conditions during those years are approximately the same. [52]

(Testimony of David Green.)

Q. Would your answer be any different whether or not the home in question was located in San Francisco or across the Bay in Alameda?

A. No, the value is approximately the same in both communities.

Mr. Rabinowitz: That is all. [53]

* * * * *

Redirect Examination * * * * *

Q. (By Mr. Rabinowitz): ——if there was a 90 percent loan against the property, would that affect your discount?

A. Oh, that definitely would, there is no question about that.

Q. Well now, you answered my previous question, "It would make no difference." Do you wish to change your answer? How would it affect it?

A. Well, definitely, a 90 percent loan against a piece of property, that would have a definite effect on that.

Q. What effect would it have?

A. The effect is that there is already a 90 percent loan against it; in other words, the value is completely gone.

Q. What effect would it have on the marketable or market value of the property?

A. There is no market value on that piece of property. Like that $5,000 piece of property, if that particular loan defaulted, if that particular loan defaulted I am immediately [59] involved with about $250 attorney fees, forgetting everything else.

* * * * *

(Testimony of David Green.)

A. * * * We have the loss of interest, the rehabilitation of that piece of property and the deterioration of that property over that period; in other words, that thousand dollars just disappears, just disappears.

Q. In your opinion, in that case there is no market value?

A. It has no market value at all.

Mr. Rabinowitz: That is all. [60]

* * * * *

[Endorsed]: T.C.U.S. Filed Nov. 23, 1954.

[Title of Tax Court and Cause.]

PETITIONERS' OPENING BRIEF

Points Relied On

* * * * *

(d) If the Regulation were interpreted as contended for by the Commissioner, a part of each installment payment actually received, or entire such installments, would be excluded. This is contrary to the specific direction of Sec. 44, which requires that a uniform percentage of each installment payment actually received, shall be recognized; and no good reason exists, for departing from this plain language.

The Commissioner's interpretation would likewise require that the excess of each mortgage over the vendor's base, be counted as part of the "initial

payment". This, too, is contrary to the specific mandate of Sec. 44, which limits "initial payments" to "payments received in cash or property other than evidences of indebtedness of the purchaser".

The Regulation, if given the interpretation contended for by the Commissioner, would, for the above reasons, be directly at variance with Sec. 44, and consequently invalid.

* * * * *

[Endorsed]: T.C.U.S. Filed Feb. 28, 1955.

[Title of Tax Court and Cause No. 42,446.]

STIPULATION OF FACTS

Supplemental Stipulation

It is hereby stipulated and agreed between the Commissioner of Internal Revenue and the above entitled petitioner, by their respective undersigned attorneys:

1. A written Stipulation of Facts (hereinafter referred to as the "Original Stipulation") was entered into between the parties hereto and filed at the trial of the above entitled case at San Francisco, California, on November 4, 1954.

2. Said Original Stipulation specified, in part, that petitioner in the year 1942 sold 15 houses and in the year 1943 sold 34 houses under contracts on which the petitioner elected to report, and reported, and was entitled to report, profits or losses on such sales of real estate as deferred payment sales not on

the installment basis. Petitioner reported in its income tax returns for the years 1942 and 1943 that it realized profits on such sales in the respective amounts of $14,705.50 and $39,615.72, which sums represented the entire profit to be realized when the purchase price had been paid in full.

3. In reporting the profit realized during the years 1942 and 1943, petitioner treated deferred payment contracts as having a fair market value of 100% of the face amount of such contracts. The deferred payment contracts which petitioner received in connection with the sale of the 15 houses sold on the deferred payment plan in 1942 and the 34 houses sold on the deferred payment plan in 1943 did not have a fair market value in excess of 66⅔% of the face value thereof at the respective dates of sale.

4. Paragraph 12 of the Original Stipulation introduced at the trial of this action sets forth the agreed income realized by petitioner in the event this Court should hold against the petitioner and in favor of the respondent on the main issue of the case, to wit, the proper method of determining the realized profits on the contracts on which petitioner elected to report its profit on the installment basis. Said paragraph inadvertently provided,

> "* * * then it is stipulated and agreed that the following schedule reflects the correct determination of income petitioner realized on installment and <u>all other sales of real estate for each of the years 1942 to 1945</u> * * *" (Underscoring added.)

The said schedule in Paragraph 12 of the Original Stipulation filed at the trial hereof reflects income realized by petitioner as if all petitioner's sales were made and reported for income tax purposes on the installment basis. In view of the present Stipulation that 49 of the sales included therein were not made on the installment basis, but in fact were made and reported for income tax purposes on the deferred payment basis, and in further view of the present Stipulation that the contracts of sale had a fair market value of only 66⅔% of their face amount, it is hereby further stipulated that said schedule in Paragraph 12 of the Original Stipulation filed at the trial shall be adjusted under Rule 50 so that it will correctly reflect the profits realized or losses sustained during each of the years 1942 to 1945, inclusive, with respect to the said 49 deferred payment sales.

Dated April 8, 1955.

/s/ R. R. HUTZOG,
Attorney for Commissioner of
Internal Revenue.

Dated April 8, 1955.

/s/ BERT F. RABINOWITZ,
Counsel for Petitioner.

Dated April 8, 1955.

/s/ SCOTT H. DUNHAM,
Certified Public Accountant,
Of Counsel.

[Endorsed]: T.C.U.S. Filed Apr. 11, 1955.

The Tax Court of the United States

24 T. C. No. 75

The Stonecrest Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent.

The Brookfield Corporation, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Docket Nos. 42445, 42446. Filed July 14, 1955.

FINDINGS OF FACT AND OPINION

Installment Sales of Mortgaged Real Property Under Section 44 (b), I.R.C. of 1939.—Under terms of agreement of sale, buyer from petitioners of real property that had a mortgage on it did not assume the mortgage or take the property subject to the mortgage within the meaning of respondent's regulation relating to the determination of the percentage of taxable income to be returned on the installment basis.

Bert F. Rabinowitz, Esq., and Scott H. Dunham, C.P.A., for the petitioners.

T. M. Mather, Esq., for the respondent.

The Commissioner determined the following deficiencies against the petitioners:

Stonecrest Corporation:

Year	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1942	$ 3,766.08	$29,678.26	$158,359.56
1943		3,883.19	42,331.60
1945	12,176.55	414.62	8,115.87

The Brookfield Corporation:

Year	Income Tax	Declared Value Excess Profits Tax	Excess Profits Tax
1942	$ 2,116.32	$ 6,514.86	$ 37,918.40
1943	21,803.05	61,998.28	309,345.48
1944	1,679.71	3,287.51	19,278.31
1945	17,686.81	1,061.54	—

Upon motion of petitioners the cases have been consolidated for hearing and decision.

The question we have to decide concerns the amount of income to be reported by petitioners on the installment basis from the sale of mortgaged real property.

Most of the facts have been stipulated. Since the methods of operation of both petitioners were essentially the same, to the extent possible circumstances relating only to petitioner Stonecrest's operations will be stated in detail in our findings of fact and are to be understood as being identical to the circumstances of Brookfield's operations. Stonecrest will hereafter be called petitioner.

Findings of Fact

The stipulated facts are found accordingly, and are incorporated herein by this reference.

Petitioner is a California corporation with its principal office in San Francisco. Its income and excess profits tax returns for the years in question, 1942 through 1945, were filed with the collector of internal revenue for the first district of California. Insofar as the sales in question here, petitioner

kept its books and records and reported its profits on the installment basis.

During the taxable years petitioner's principal business was the construction of housing developments consisting of individual residences.

Petitioner's method of operation was as follows: It first purchased land from a partnership whose members were also shareholders of petitioner. The partnership had previously purchased an unimproved tract of land, the purchase price being financed partially by partnership funds but principally by a loan from a San Francisco bank. The loan was evidenced by a promissory note executed by the partners and their wives and secured by a blanket deed of trust covering the entire tract in favor of the lending bank. Petitioner then submitted its plans for building individual residences to the Federal Housing Administration to obtain the latter's commitment to insure loans on the property. Having obtained the general approval of the F.H.A., petitioner applied to a bank for loans for the construction of individual housing units, which were made after an F.H.A. commitment to insure each loan had been received. In connection with the loan petitioner executed a deed of trust note and a deed of trust on each unit, which was recorded by the bank. The original blanket deed of trust on the entire tract was released on individual lots as loans for the construction of housing units on these lots were made. An agreed release price was paid to the mortgagee out of the construction loan. When all of the lots in the subdivisions developed by peti-

tioner were subject to individual deeds of trust, the stockholders of petitioner and their wives, who had personally signed the original note and blanket deed of trust, were released from their personal liability thereon, so that only the petitioner was liable to the lending bank on the deed of trust notes with respect to houses covered by installment contracts that had not been closed. In the case of Brookfield, the shareholders and their wives were required personally to guarantee each individual note secured by individual deeds of trust on the houses constructed and sold, and they were never relieved of their secondary liability on such loans until the loans were either paid in full or, as in a few cases not in issue here, assumed by the purchasers.

Among the documents executed by a purchaser from petitioner was a "Mortgagor's Statement" contained in a "Mortgagee's Application For Mortgage Insurance," which was filed by the lending bank with the F.H.A. together with a "Consent to Substitution of Mortgagors Under Title VI." The Mortgagor's Statement contained information regarding the financial status of the mortgagor for the guidance of the F.H.A. in determining whether to insure a mortgage loan on the property being purchased by the mortgagor. When a house was ready for occupancy, a "Uniform Agreement of Sale" was executed by the purchaser and petitioner, and the purchaser also executed that portion of the Consent to Substitution of Mortgagors under Title VI. designated "Purchaser's Certificate," which acknowledged his receipt of the property and con-

tained his agreement to pay the mortgage debt. The purchaser also executed a guarantee to the mortgagee bank of petitioner's obligation on the mortgage loan, and a quitclaim deed to the property in favor of petitioner. Neither the bank nor the F.H.A. retained an executed copy of the Purchaser's Certificate or the purchaser's guarantee of the loan made to petitioner.

The Uniform Agreement of Sale provided in part as follows:

That said Seller hereby agrees to sell and convey to the Purchaser, and Purchaser hereby agrees to purchase, that certain real property situated in the City and County of San Francisco, State of California, described as follows:

[description of property]

The purchase price for said property which Purchaser agrees to pay and Seller agrees to accept therefor, is the sum of $4,450.00, payable as follows:

$100.00 in cash, receipt of which is hereby acknowledged;

$47.40 per month payable on the 1st day of each and every month hereafter for a period of 27 months, (first period), and thereafter $33.50 per month, payable on same day of each month until purchase price and interest are paid in full (second period). Seller heretofore executed a promissory note to The San Francisco Bank in the principal sum of $4,000.00, and a trust deed conveying said real property to E. T. Kruse and Parker S. Maddux, as trustees, to secure the payment of said note

(pursuant to the provisions of Title 6, F.H.A.) Reference is hereby made to the record of said trust deed in the office of the Recorder of the City and County of San Francisco, and the same is hereby incorporated herein. Said installments payable during the first and second periods include interest and charges at the rate and as provided for in said note and trust deed upon that portion of purchase price represented thereby. Installments payable during the first period include interest at the rate of 6% per annum on balance of purchase price. Said installments shall be applied by the Seller to the requirements of said F.H.A. loan and to the payment of balance of purchase price and interest thereon. Monthly installments payable pursuant to said F.H.A. loan are subject to increase or decrease as provided for in said note and trust deed representing the same, and in the event of such increase or decrease, installments payable hereunder shall be increased or decreased accordingly. Seller shall deliver and Purchaser shall accept conveyance of said property upon first period installments being paid in full at any time thereafter within five years therefrom at option of Seller, and Purchaser shall thereupon assume the performance of Seller's unperformed obligations under the terms of said note and trust deed, and Purchaser hereby consents to Seller being then released therefrom. For this purpose, Purchaser executes an assumption concurrently herewith, delivers the same to Seller, and the Seller is authorized to deliver said assumption to The San Francisco Bank upon delivery of said

conveyance. Thereafter balance of purchase price shall consist of monthly payments required by said note and trust deed provided in the event Seller cannot secure said release of liability from said note and trust deed, Seller may withhold delivery of conveyance and parties shall function under this agreement until such release is obtained or Seller may deliver conveyance at any time sooner if Seller so elects. * * * * *

Purchaser concurrently herewith executes and delivers to Seller a quitclaim deed to said property. Seller may at any time after default by the Purchaser in the performance of the obligations herein provided for, record said quitclaim deed. Said quitclaim deed shall be returned to Purchaser upon Purchaser's becoming entitled to a conveyance hereunder.

Other provisions related to taxes on the property, title and possession. Some of the sales agreements used by petitioner varied from the form set out above; instead of the requirement that the Seller deliver and the buyer accept conveyance of the property within five years after the first-period installments had been made, the option is given to the buyer to require a conveyance of the property after eight (in some agreements, twelve) years from the agreement date.

Although the agreement called for the concurrent execution of an assumption of the mortgage by the purchaser, to be used when property was conveyed to a purchaser, the document actually signed was the purchaser's guarantee of petitioner's mortgage

loan. Even if title had passed before complete performance by the purchaser, the petitioner would have remained primarily liable to the bank for the unpaid amount of the mortgage.

Petitioners reported the following number of sales between 1942 and 1945 on the installment basis:

Year	Stonecrest	Brookfield
1942	349	103
1943	88	605
1944	9	
1945	91	
	537	708

The level of payments that the purchaser was required to make during the first 27 months was greater than the level of payments during the remaining period of the installment contract, the difference in level representing the excess of purchase price (less down payment) over the original amount of the mortgage loan plus interest on the excess.

In no single case under the Uniform Agreement of Sale did the petitioner exercise its option to deed property to a purchaser. In no single case under any agreement of sale did a purchaser exercise an option to receive a deed prior to full payment of the total purchase price.

All monthly payments on contracts were made directly to the petitioner by the purchaser, and all monthly payments due on loans were made directly by the petitioner to the bank until the property was deeded to the purchaser, at which time the purchaser's contract account was closed and the un-

realized profit applicable thereto was reported as income for that year. There was no intended synchronization between the time fixed for payments due from purchasers on homes sold under installment contracts and the time fixed for payments by petitioner to the bank on its loans secured by deeds of trust on the properties sold on the installment plan.

The lending bank (mortgagee) carried all loans on its books and records as loans due from the petitioner from the date each individual loan was granted until the closing-out of the installment contract pertaining to the property on which petitioner had executed a deed of trust as security for the loan.

Every installment sales contract reflected on petitioner's books was closed by petitioner at the time the property covered by the contract was deeded to the purchaser. In substantially all cases the property covered by an installment sales contract was not deeded to the purchaser until the purchaser paid the amount remaining due on the installment sales contract, and, concurrently with the receipt of such sum, petitioner paid the bank the amount due on the loan which was secured by a deed of trust on the property covered by the installment sales contract. In a few cases, by special arrangement between the petitioner and purchaser, the petitioner has nevertheless deeded property to a purchaser without requiring payment of the purchase price in full. In each of such cases, which in the aggregate represent only a small percentage of the total num-

ber of contracts, the deed was issued for individual and personal reasons and not as a matter of right on the part of either party. In such cases the party receiving the deed made arrangements with the bank to assume the mortgage on the property in question and paid petitioner any amount due on the installment sales contract in excess of the amount due on the deed of trust note. In every instance in which a deed was issued to a purchaser, such purchaser's installment sales contract was closed, and petitioner reported as income in that year the entire amount of the unrealized profit on the installment sale. None of the transactions described in this paragraph involved the exercise of any option given to either party under any of the agreements of sale.

The petitioners reported as income from the sales in question here that proportion of the installment payments actually received which the gross profit to be realized on the sale bore to the total contract price. "Total contract price" was considered to be the amount for which a property sold, without any deduction for the amount of the mortgage.

In determining the percentage of each installment to be returned as income in the taxable years the respondent, following the regulation, included the amount of the mortgage in the "selling price" but excluded it from the "total contract price" to the extent that it did not exceed the seller's basis in the property. Since in each of the sales made by petitioners the mortgage on the property exceeded the seller's basis, the respondent added the excess to the basis to determine "total contract price."

Included in "initial payments" were the buyer's down payment, payments on the purchase price during the taxable period when the sale was made, and the excess of the mortgage over the seller's basis. Using this method respondent determined that 100 per cent of the installment payments received by petitioners during the years in question should be reported as profit for those years, with the exception of the year 1945 as to Stonecrest, for which the percentage is 83.5.

Opinion

Tietjens, Judge: Where property is sold on the installment plan the seller may return as income from the sale in any taxable year the proportion of the installment payments actually received in that year which the gross profit on the sale bears to the total contract price. Section 44, Internal Revenue Code of 1939.[1] This provision, enacted in the Rev-

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[1] Sec. 44. Installment Basis.

(a) Dealers in Personal Property.—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty.—In the case * * * of a sale or other disposition of real property, if * * * the initial payments do not exceed 30 per centum of the selling price * * *, the income may, under regulations prescribed by the Commissioner with the approval of

enue Act of 1926,[2] relieved a seller from having to pay an income tax in the year of sale based on the full amount of anticipated profits when in fact only a small portion of the sales price had been received. Commissioner v. South Texas Lumber Co., 333 U.S. 496 (1948). It permitted him to distribute the profit on an installment sale over the years during which the purchase money would be actually received, by dividing the payments into parts representing a return of capital and profit. In the case of real property sold on the installment plan where there was a mortgage on the property which the buyer either assumed or took the property subject to, the statutory scheme of returning a portion of each payment as income in the year received did not reach all of the seller's profit, since the total amount of the selling price was not paid over by the buyer to the seller; that portion of the selling price represented by the mortgage was paid by the buyer directly to the mortgagee. To remedy this regulations were issued by the Commissioner and approved by the Secretary of the Treasury to provide that the amount of the mortgage, to the extent that it did not exceed the seller's basis in the property sold, was not to be considered a part of the "initial payments" or of the "total contract price." Treas-

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the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

[2] Section 212 (d), 44 Stat. 23.

ury Regulations 69, Article 44, promulgated August 28, 1926; amended by Treasury Decision 4255, January 8, 1929, C.B. VIII-1, p. 165. The reduction in the "total contract price" had the effect of increasing the percentage of each installment payment to be returned as income, thereby reaching the entire profit on the sale. The amount by which the mortgage exceeded the seller's basis in the property was treated as a part of the "initial payments" and was added to the seller's basis in computing "total contract price." The regulation was upheld in a case involving the sale of mortgaged property where the buyer unequivocally "assumed" the mortgage, as a fair attempt to carry out the intent of Congress. Burnet v. S. & L. Bldg. Corp., 288 U.S. 406 (1933).

The wording of the regulation, insofar as it relates to the question here, is as follows:

> Regulations 111:
>
> Sec. 29.44-2. Sale of Real Property Involving Deferred Payments.— * * * * *
>
> In the sale of mortgaged property the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser, shall be included as a part of the "selling price," but the amount of the mortgage, to the extent it does not exceed the basis to the vendor of the property sold, shall not be considered as a part of the "initial payments" or of the "total contract price," as those terms are used in section

44, in sections 29.44-1 and 29.44-3, and in this section.

The above form of the regulation is the same as that approved by the Supreme Court in Burnet v. S. & L. Bldg. Corp., supra.

In determining the deficiencies here involved the respondent followed the procedure described in our findings of fact and applied the regulation to the sales made by petitioners, claiming that according to the terms of the agreement of sale a buyer, in effect, assumed the mortgage obligation, or at least that the property was taken subject to the mortgage.

Whether respondent has properly determined the amount of reportable income received by petitioners turns on whether a buyer from petitioners either assumed the mortgage on the property or took the property subject to the mortgage within the meaning of the regulation.

While the regulation first refers broadly to "the sale of mortgaged property," the language following this broad reference describes the two types of sales of mortgaged property to which the regulation applies: (a) where a buyer takes property subject to a mortgage, or (b) assumes the mortgage. These expressions we take to have the meaning customarily attributed to them in transactions concerned with the transfer of mortgaged property. Crane v. Commissioner, 331 U. S. 1, 6 (1947). Taking property subject to a mortgage means that the buyer pays the seller for the latter's redemption interest, i.e., the difference between the amount of the mortgage debt and the total amount for which the prop-

erty is being sold, but the buyer does not assume a personal obligation to pay the mortgage debt. The buyer agrees that as between him and the seller, the latter has no obligation to satisfy the mortgage debt, and that the debt is to be satisfied out of the property. Although he is not obliged to, the buyer will ordinarily make the payments on the mortgage debt in order to protect his interest in the property. Where a buyer assumes a mortgage on property, he pays the seller for the latter's redemption interest, and in addition promises the seller to pay off the mortgage debt. This promise of the buyer can ordinarily be enforced by the mortgagee. 5 Tiffany, The Law of Real Property, sections 1435, 1436 (3rd ed. 1939); IV American Law of Property, sections 16.125, 16.127, 16.128-16.132 (1952).

The typical agreement of sale used by petitioners, as set out fully in our findings of fact, first specified the purchase price of the property and then provided the manner of payment: a down payment of $100, monthly payments of $47.40 for 27 months (first period), and then of $33.50 until the purchase price and interest were paid in full (second period). Mention is then made of a deed of trust (mortgage) conveying the property to trustees to secure payment of a promissory note executed by the seller. The agreement states that the installment payments include interest and charges at the same rate and as provided in the promissory note secured by the deed of trust, and the seller is required to apply the installment payments to the loan and to the rest of the purchase price and interest thereon.

Provision is then made that the seller shall deliver and the buyer accept conveyance of the property within 5 years (8 and 12 years in some agreements) after the first-period installment payments have been made. The option is given to the buyer to determine when in the 5-year (sometimes 8 and 12) period the conveyance will be made. In some agreements an option is given to the buyer to require conveyance of the property within a period of years after the agreement date. Upon conveyance the buyer is to assume payment of the promissory note secured by the deed of trust. After assumption the buyer's payments on the purchase price were to be the monthly payments required by the promissory note, but in the event the seller could not obtain a release from its obligation on the promissory note from the lending bank, the seller could withhold conveyance of the property until a release of its liability was obtained, or could make the conveyance at any time sooner.

The foregoing provisions of the agreement make it clear that there was no assumption of the mortgage when a property was sold by petitioners. As is clearly stated, the buyer agreed to assume the mortgage upon conveyance of the property by the seller at some time from 5 to 12 years after the first-period installments had been made. The regulation has no application until there is an actual assumption. The fact that the seller was to use the installment payments to pay off the mortgage debt does not constitute an assumption of the mortgage by the buyer. As we have pointed out, assump-

tion of a mortgage means that the buyer takes over the seller's obligation to the mortgagee and incurs an obligation generally enforceable by the mortgagee. Here, as the parties have stipulated, the buyer was under no present obligation to the mortgagee.

Nor was any sale made by petitioner "subject to" a mortgage in the ordinary usage of that expression. The expression means that the buyer has no personal obligation to pay the mortgage debt; that, as between seller and buyer, the seller has no obligation to pay the debt; and that the debt is to be satisfied from the property. Here there was no understanding that the debt was to be satisfied out of the property; instead it was explicitly provided in the agreement of the parties that the seller was to make the payments on the mortgage debt until there was a conveyance of the property. It has been stated that in determining whether or not a transfer is subject to a mortgage:

> A circumstance which is usually of controlling importance in this regard is whether the mortgage was considered in adjusting the purchase price. If the price was reduced by reason of the mortgage, it is a reasonable conclusion that it was intended that the debt, either in whole or in part, should be imposed on the land in the hands of the transferee rather than on the transferor, while if the full agreed value of the land was paid, it may be concluded that the parties intended the grantor to pay the

mortgage debt out of the proceeds of the sale.

[Tiffany, sec. 1435, p. 365.]

In this case there was no reduction in selling price because of the mortgage and it seems clear that the seller was intended to pay the mortgage debt out of the proceeds of the sale. By his interpretation respondent would extend the application of the regulation to every sale of property that has a mortgage on it. While in a sense every sale of mortgaged property is subject to a mortgage since the property remains liable to have the mortgage debt satisfied from it, we think the expression was used in the regulation in its customary meaning, to define the obligations of the parties to a sale of property with respect to the mortgage debt. See Tiffany, supra, sec. 1435.

The position taken by respondent here appears contrary to G.C.M. 3048 (C.B. VII-1, p. 60, Jan.-June, 1928), where it was ruled that the regulation in question was inapplicable. The form of the regulation there involved contained language identical to that before us (vis., "In the sale of mortgaged property * * *, whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser"). The situation dealt with in the ruling was one where real estate against which there was a "reducing mortgage" was sold on installments. The purchaser did not assume the mortgage but made monthly payments to the vendor who in turn made the mortgage payments, similarly to the case here. It was held that

the rule prescribed in the regulations for the determination of the percentage of profit returnable each year in the case of mortgaged property sold on the installment plan was inapplicable.

The cases relied on by respondent—Burnet v. S. & L. Bldg. Corp., supra; Dalriada Realty Co., Inc., 5 B.T.A. 905; Pacheco Creek Orchard Co., 12 B.T.A. 1358; Katherine H. Watson, 20 B.T.A. 270; and Fifty-Three West Seventy-second Street, Inc., 23 B.T.A. 164, are distinguishable. In all of those cases with the exception of Pacheco Creek Orchard Co., the mortgage was assumed by the vendee. In the Pacheco case payment of the mortgage was made by the vendee to the mortgagee and it was held that while the mortgage was not "assumed," the property was "purchased subject to the mortgage," and the regulation applied.

In summary, we think that the type of transaction entered into by petitioner with a purchaser is apparent from the face of the agreement of sale. It was an agreement by the parties that the purchaser was to make payments on the purchase price for a period of time, after which petitioner was to pass title to the property and the purchaser was to take over the remaining mortgage payments. There was no present assumption of the mortgage nor was the property taken subject to the mortgage, as those expressions are customarily used. Respondent therefore erred in subtracting the amount of the mortgage from the "total contract price" in determining the percentage of income from installment sales to be returned by petitioners during the

taxable years in question; and also erred in including the excess of the mortgage over the seller's basis in "initial payments."

In the event we decide this issue for petitioners, which we do, the parties have stipulated the figures to be used in determining how much installment income should be reported in the taxable years.

In view of other concessions,

Decisions will be entered under Rule 50.

Served July 14, 1955.

The Tax Court of the United States
Washington

Docket No. 42445

THE STONECREST CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed July 14, 1955, the parties having filed on October 11, 1955, an agreed computation of tax, now, therefore, it is

Ordered and Decided: That there is no deficiency or overpayment in income tax, declared value excess profits tax, or excess profits tax for the year 1942; that there is a deficiency in income tax in the amount of $193.16, for the year 1943; that there is no deficiency or overpayment in declared value excess profits tax, and that there is an overpayment of excess profits tax in the amount of $958.00, which amount is subject to adjustment for post-war refund credit, and which amount was paid within three years before the execution of an agreement by both the Commissioner and the Taxpayer pursuant to section 276 (b), Internal Revenue Code of 1939 to extend beyond the time prescribed in section 275 the time within which the Commissioner might assess the tax, which agreement was executed within three years from the time the return was filed by the Taxpayer, for 1943; and that there is a deficiency in income tax in the amount of $4,717.75 and no deficiency or overpayment in declared value excess profits tax or excess profits tax for the year 1945.

Entered: Oct. 13, 1955.

[Seal] /s/ NORMAN O. TIETJENS,
Judge.

Served: Oct. 14, 1955.

The Tax Court of the United States
Washington

Docket No. 42446

THE BROOKFIELD CORPORATION,
Petitioner,
v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed July 14, 1955, the parties having filed on October 11, 1955, an agreed computation of tax, now, therefore, it is

Ordered and Decided: That there are no deficiencies or overpayments in income tax, declared value excess profits tax or excess profits tax for the years 1942 and 1943; that there is no deficiency or overpayment in excess profits tax for the year 1944; that there is no deficiency or overpayment of declared value excess profits tax or excess profits tax for the year 1945; and that there are overpayments of income tax and declared value excess profits tax for the year 1944 in the respective amounts of \$25,507.49 and \$972.95, and that there is an overpayment of income tax in the amount of \$3,558.52 for the year 1945, all of which amounts were paid within three years before the execution of an agreement by both the Commissioner and the Taxpayer

pursuant to section 276 (b), Internal Revenue Code of 1939 to extend beyond the time prescribed in section 275 the time within which the Commissioner might assess the tax, which agreement was executed within three years from the time the return was filed by the taxpayer.

Entered: Oct. 13, 1955.

[Seal] /s/ NORMAN O. TIETJENS,
Judge.

Served: Oct. 14, 1955.

In The United States Court of Appeals
For The Ninth Circuit

T.C. Docket No. 42445

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

v.

THE STONECREST CORPORATION,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on October 13,

1955, ordering and deciding that there is no deficiency or overpayment in income tax, declared value excess profits tax, or excess profits tax for the year 1942; that there is a deficiency in income tax in the amount of $193.16, for the year 1943; that there is no deficiency or overpayment in declared value excess profits tax, and that there is an overpayment of excess profits tax in the amount of $958.00, which amount is subject to adjustment for post-war refund credit, and which amount was paid within three years before the execution of an agreement by both the Commissioner and the Taxpayer pursuant to section 276 (b), Internal Revenue Code of 1939 to extend beyond the time prescribed in section 275 the time within which the Commissioner might assess the tax, which agreement was executed within three years from the time the return was filed by the Taxpayer, for 1943; and that there is a deficiency in income tax in the amount of $4,717.75 and no deficiency or overpayment in declared value excess profits tax or excess profits tax for the year 1945. This petition for review is filed pursuant to the provisions of sections 7482 and 7483 of the Internal Revenue Code of 1954.

The taxpayer's income tax returns were filed with the Collector of Internal Revenue for the First District of California whose office is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

Nature of Controversy

The case presents for adjudication the question

whether under terms of agreements of sale the buyers from the taxpayer of real property that had a mortgage on it did not assume the mortgage or take the property subject to the mortgage within the meaning of Treasury Regulations 111 Sec. 29.44-2 relating to the determination of the percentage of taxable income to be returned on the installment basis as permitted by Sec. 44(b), Internal Revenue Code of 1939.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General,

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service, Counsel for Petitioner on Review.

[Endorsed]: T.C.U.S. Jan. 12, 1956.

In The United States Court of Appeals
For The Ninth Circuit

T.C. Docket No. 42446

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

v.

THE BROOKFIELD CORPORATION,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

The Commissioner of Internal Revenue hereby

petitions the United States Court of Appeals for the Ninth Circuit to review the decision entered by The Tax Court of the United States on October 13, 1955, ordering and deciding that there are no deficiencies or overpayments in income tax, declared value excess profits tax or excess profits tax for the years 1942 and 1943; that there is no deficiency or overpayment in excess profits tax for the year 1944; that there is no deficiency or overpayment of declared value excess profits tax or excess profits tax for the year 1945; and that there are overpayments of income tax and declared value excess profits tax for the year 1944 in the respective amounts of \$25,507.49 and \$972.95, and that there is an overpayment of income tax in the amount of \$3,558.52 for the year 1945, all of which amounts were paid within three years before the execution of an agreement by both the Commissioner and the Taxpayer pursuant to section 276 (b), Internal Revenue Code of 1939 to extend beyond the time prescribed in section 275 the time within which the Commissioner might assess the tax, which agreement was executed within three years from the time the return was filed by the taxpayer. This petition for review is filed pursuant to the provisions of sections 7482 and 7483 of the Internal Revenue Code of 1954.

The taxpayer's income tax returns were filed with the Collector of Internal Revenue for the First District of California whose office is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit.

Nature of Controversy

The case presents for adjudication the question whether under terms of agreements of sale the buyers from the taxpayer of real property that had a mortgage on it did not assume the mortgage or take the property subject to the mortgage within the meaning of Sec. 29.44-2 Treasury Regulations 111 relating to the determination of the percentage of taxable income to be returned on the installment basis as permitted by Sec. 44(b), Internal Revenue Code of 1939.

/s/ H. BRIAN HOLLAND,
Assistant Attorney General,

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service, Counsel for Petitioner on Review.

[Endorsed]: T.C.U.S. Filed Jan. 12, 1956.

[Title of Court of Appeals and Causes.]

STATEMENT OF POINTS

Comes Now the petitioner on review herein and makes this concise statement of points on which he intends to rely on the review herein, to-wit:

The Tax Court of the United States erred:

1. In holding that the regulation in question (Sec. 29.44-2, Regulations 111) applies only (a)

where a buyer takes property subject to a mortgage, or (b) assumes the mortgage.

2. In failing to hold that the regulation in question (Sec. 29.44-2, Regulations 111) applies in all cases of installment sales of mortgaged property sold subject to the mortgage.

3. In holding that under the terms of the agreement of sale, the buyer from taxpayers of real property that had a mortgage on it did not assume the mortgage or take the property subject to the mortgage within the meaning of Sec. 29.44-2 of Regulations 111 relating to the determination of the percentage of taxable income to be returned on the installment basis.

4. In failing to hold that under the terms of the agreement of sale, the purchasers of mortgaged real property either "assumed" the mortgages or took the properties "subject to" the mortgages within the meaning of Regulations 111, Sec. 29.44-2.

5. In failing to hold that the taxpayers sold mortgaged property on the installment plan within the ambit of Regulations 111, Sec. 29.44-2.

6. In holding that the Commissioner erred in subtracting from the total contract price, the amount of the mortgage to the extent that it did not exceed the seller's basis in the property, in determining the percentage of income from installment sales to be returned by taxpayers during the taxable years in question, and also erred in including the excess

of the mortgage over the seller's basis in initial payments.

7. In failing to uphold the action of the Commissioner in following Regulations 111, Sec. 29.44-2, with the result, that the amount of the mortgage, to the extent that it did not exceed the basis of the property, should be deducted from the "selling price" to determine the "total contract price"; and that the excess of the mortgage over basis was includible in determining the initial payment.

8. In holding that G.C.M. 3048, C.B. VII-1, p. 60 (1928) is indistinguishable from the instant cases.

9. In failing to uphold the deficiencies as determined by the Commissioner.

10. In that its opinion and decisions are contrary to law and regulations.

/s/ CHARLES K. RICE,
Acting Assistant Attorney General,

/s/ JOHN POTTS BARNES,
Chief Counsel, Internal Revenue Service, Counsel for Petitioner on Review.

Statement of Service Attached.

[Endorsed]: T.C.U.S. Filed March 15, 1956.

[Title of Tax Court and Causes Nos. 42445, 42446.]

CERTIFICATE

I, Howard P. Locke, Clerk of The Tax Court of the United States, do hereby certify that the fore-

going documents, 1 to 49, inclusive, constitute and are all of the original papers and proceedings, including exhibits 1(a), 1(b), (Dk. No. 42445), 1-A, 2-B, (Dk. No. 42446), 3(b), 3(c), 3(d), 3(e), 3(f), 4(a), 5(a), 5(b), 5(c), 6(a), 6(b), 6(c), (Dk. No. 42445), 6(d), 7(a), 7(a-1), 7(a-2), 7(a-3), 7(b), 7(c), 7(d), 7(e), 8(a), 8(b), 8(c), 9(a), 9(b), 9(c), 9(d), attached to stipulations of facts, and respondent's exhibits E thru L, admitted in evidence, as called for by the Statement "Re Diminution of Record" on file in my office as the original and complete record in the proceedings before The Tax Court of the United States entitled: "The Stonecrest Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Dk. No. 42445," "The Brookfield Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Dk. No. 42446," and in which the respondent in the Tax Court proceedings has initiated appeals as above numbered and entitled, together with a true copy of the docket entries in said Tax Court proceedings, as the same appear in the official docket book in my office.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 28th day of March, 1956.

[Seal] /s/ HOWARD P. LOCKE,
Clerk, The Tax Court of the United States.

[Endorsed]: No. 15096. United States Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. The Stonecrest Corporation and The Brookfield Corporation, Respondents. Transcript of the Record. Petitions to Review Decisions of The Tax Court of the United States.

Filed: April 9, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In The United States Court of Appeals
For The Ninth Circuit

Tax Court Docket Nos. 42,445 and 42,446

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

THE STONECREST CORPORATION and THE BROOKFIELD CORPORATION,
Respondents.

STIPULATION

It is hereby stipulated and agreed by and between the attorney for the respondents and the petitioner in the above-entitled causes, subject to the approval of the Court, that:

1. The two above-captioned cases now pending

before the Court of Appeals for the Ninth Circuit may be consolidated for review and for printing the record on review, briefing, hearing, argument and decision, and

2. The exhibits attached to the stipulation of facts (Document Nos. 21 and 22) need not be printed in the record but may be incorporated therein by reference so that any part thereof may be printed in appendices to the briefs of the parties or relied upon in hearing and argument, and considered by the Court of Appeals for decision on review.

Dated: April 19, 1956.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Petitioner.

/s/ BERT F. RABINOWITZ,
Attorney for Respondents.

[Endorsed]: Filed May 15, 1956. Paul P. O'Brien, Clerk.

[Title of Court of Appeals and Causes.]

STIPULATION

It is hereby stipulated and agreed by and between the attorney for the respondents and the petitioner in the above-entitled causes, subject to the approval of the Court, that:

The respondents' Exhibits E through L, admitted in evidence in the Tax Court below (Document No. 27), need not be printed in the record but may be incorporated therein by reference so that any part thereof may be printed in appendices to the briefs of the parties or relied upon in hearing and argument, and considered by the Court of Appeals for decision on review.

Dated: May 18, 1956.

/s/ CHARLES K. RICE,
Assistant Attorney General,
Attorney for Petitioner.

/s/ BERT F. RABINOWITZ,
Attorney for Respondents.

[Endorsed]: Filed May 22, 1956. Paul P. O'Brien, Clerk.